STUDIES IN INDIAN ECONOMICS

EDITED BY

C. N. VAKIL

UNIVERSITY PROFESSOR OF ECONOMICS, BOMBAY.

STUDIES IN INDIAN ECONOMICS

A series of volumes dealing with the economic history and problems of Modern India

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TAXATION OF INCOME
IN
INDIA

BY

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EDITOR'S PREFACE

The object and scope of this work have been lucidly explained by the author in the Introduction. When Mr. Rao began his studies in Income-Tax under my guidance, as a research scholar in this School in 1927, the only economic work of importance on the subject was Dr. Pagar's 'Indian Income Tax'. This is a historical study and does not contain an analysis of the Indian system. In view of the increasing importance of Taxation of Income in this country, a critical analysis of the prevailing system and its comparison with that of other countries was likely to meet a real want. Mr. Rao entered on this task full of enthusiasm and an idealistic outlook imbibed from the teachings of Professor P. A. Wadia who is well-known in Western India as the inspiring teacher of many grateful young men now shouldering the responsibilities of life in different spheres. Mr. Rao finished his work in April 1929, and was awarded the M. A. degree of this University with distinction on the same. Before he could revise the work with a view to publication, two other works were published dealing with Indian Income-Tax, namely, (1) Dr. Bannerjea's 'History of Indian Taxation' and (2) Mr. Niyogi's 'Evolution of the Indian Income-Tax'. The former contains a long chapter on Income-Tax, and the latter is by its very title a historical volume, though some attempt to analyse the present system has been made in it. Though the present work takes note of some more points of historical importance than is the case with Dr. Pagar's book, it must be admitted that the historical aspect is treated more fully in the volumes referred to above. The historical portion in the present work serves as an introduction to a more detailed study of the problems of the Indian Income-Tax system in the light of the experience of other countries, and of the latest theoretical principles regarding the subject. It is in this sphere that the real importance of Mr. Rao's work lies, particularly in view of the possibility of a

complete overhauling of the Indian system which has been promised by Sir George Schuster, Finance Member, Government of India. His approach in most cases is bold, and attacks the root of the problem; his enthusiasm is tempered by the rigid requirements of scientific treatment, and his conclusions are therefore refreshing on the one hand and convincing on the other.

I may add that the authorities of the University of Bombay very kindly gave a substantial grant towards the cost of this publication.

C. N. Vakil.

School of Economics
and Sociology.
University of Bombay,
1st May 1931.

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F.S. .... Financial Statement together with discussions on the same in the Imperial Legislative Council.

S. C. .... Select Committee on East Indian Finance.

M. M. P. ...... Moral and Material Progress of India—Reports, annual and decennial.

B. C. C. ...... Report of the Bombay Chamber of Commerce.

I. T. C. ...... Income Tax Cases.

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T. E. or T. E. Committee — Taxation Enquiry Committee—Report and Minutes of Evidence.

R. C. on I. T. Royal Commission on Income Tax—Report and Minutes of Evidence.

L. A. D. ...... Legislative Assembly Debates.

F. A. .... Finance Act.

INTRODUCTION

Along with the growth of the democratic ideal in the political field during the last century, there also grew up a corresponding tendency to apply principles of justice to the realm taxation. This tendency found concrete expression in the introduction of the income-tax. Like a number of other democratic institutions, the income-tax first originated in England, though its immediate cause was more the need for revenue to meet the expenses of the Revolutionary Wars than an appreciation of its ethical qualities. As a matter of fact, the tax met with a very hostile reception, and had to be given up at the end of the Napoleonic Wars, though its fiscal effectiveness was proved beyond question during the short tenure of its existence. It is characteristic of English genius for theory to follow practice, and the income-tax was on exception. The tax was reintroduced by Sir R. Peel and managed to survive, in spite of repeated forecasts of its extinction including the celebrated "bribe to the electors" made by Gladstone in 1874; and to-day it forms the corner stone of the English tax system yielding an annual income of £ 235 millions,[1] as contrasted with the £ 18 millions it yeilded at its first inception. Besides being a powerful fiscal engine, the tax has been improved almost beyond recognition by the addition of differentiation, graduation and family allowances; so that it is an embodiment of justice in taxation, based, as it is, on the canon of "ability to pay". From England, the tax moved to the continent and rapidly increased in popularity, gaining additional significance as a redistributor of tax burdens, and thereby becoming a plank in the Fabian-cum-socialist platform. The advent of the Great War of 1914 with its immense need for additional revenue gave a further impetus to the extension of the income-tax, and several important countries

[1] Approximately for 1928-29, Statistical Abstract of U. K., Seventy-fourth Issue.

joined the ranks of income-tax levying nations. To-day there is hardly a country of note which does not levy an income-tax, while those which do not are fast trying to fall into line by introducing it[1]. The income-tax has undoubtedly come to stay.

For the first and probably the best exposition and popularisation of the principles underlying the income-tax, the world owes a great debt of gratitude to Professor Seligman. It was he who gave the final death-blow to the vociferous claims of the principle of proportion and established the majesty of that of progression. He followed it by a very detailed study of the income-tax in 1913, which is still a classic on the subject. Simultaneously the British Foreign Office published an enquiry into the systems of income-tax prevalent abroad, and it was followed in 1926 by a somewhat similar, though more restricted study by Mr. A. Bernard for the Senate of the United States of America. The reports and minutes of evidence given before the British Royal Commission on Income-Tax in 1920, form the most valuable material ever printed with regard to the income-tax, both in relation to theory and practice. The latest study on the subject comes from Mr. H. B. Spaulding of the London School of Economics whose work is a comparative study of the income-tax systems of Great Britain and the United States of America. It is clear that the income-tax has as much succeeded in attracting the attention of theorists as it has in forcing itself on practical financiers.

We may now turn our attention to the Indian position. Income-tax was first introduced in India in 1860 by Wilson, the first Finance Member of the Indian Government. It had a chequered career for the next 13 years, when it was allowed to lapse in 1873. It was revived in 1886, and continues to exist to the present day after acquiring a fairly steep progression as a result of the War.

The history of the Indian income-tax is interesting for the way in which expediency and the need of the moment have dominated its provisions and principles. It was introduced in 1860 in order to make up an expected deficit; it was abandoned

[1] Ceylon is the latest example of such an attempt.

in 1873 because of its unpopularity. It was revived in 1886 to meet pressing financial needs. Progression was added to it in 1916 out of similar motives. It was reformed in 1918 because of administrative difficulties in its working; it was remoulded in 1922 on account of a perverse High Court decision. And every year sees new amendments intended to meet difficulties found to exist in practice. In recent years substantial additions to the rates have also been made. Throughout the whole of its long career, the Indian income-tax has never been subjected to a rigorous theoretical scrutiny. There has been nothing in India corresponding to the different Select Committees appointed by the House of Commons at various times (1859, 1869, 1905, 1908) to enquire into the principles and working of the British income-tax; nor has there been any Indian Commission or Committee corresponding to the British Royal Commission on Income-Tax. No attempt has been made to enquire whether the Indian income-tax is based on and contains all the elements arising from correct principles of taxation; whether it corresponds to modern theory and modern practice, and whether it needs a more or less thorough overhauling. The need for such an analytical and comparative study of the Indian Income-Tax and its relation to modern principles of taxation as illustrated and modified by modern practice is undoubtedly great; and such a study was long overdue. It was in order to supply this want that the present writer took up this subject as a research student in the University of Bombay.

The work has been divided into two parts, viz. Historical and Analytical. The historical portion is a comparatively short survey, and reviews the history of the tax from its original inception in 1860 to the latest amendment in 1929[1]. This historical survey finds place in this work chiefly because the present position and our criticisms thereon cannot be properly understood except in the light of the past. The main portion of this work, however, is the analytical one. This contains an analysis of the Indian Income-Tax system in the light of the doctrine of ability, enunciated by Sir Josiah Stamp in his "Fundamental Principles of Taxation", as

[1] Recent changes have been given in an appendix.

modified by the prevalent practice abroad. The arrangement is on similar lines; Chapters IV, V and VI examine the scope of the tax, Chapter VII analyses the income concept from the point of view of the time element and the expenses involved in the creation of the income. Chapters VIII and IX look to the personal side of the income. Chapter VIII deals with the way in which the income is spent, while Chapter IX is concerned with the amount of the income and the way in which it is earned. Chapter X treats of the impersonal classes of income-tax payers such as companies, firms and Hindu Undivided Families, while Chapter XII contains a brief discussion of some of the administrative problems attendant on our income-tax system. No apology is needed for Chapters XI and XIII. The former deals with the well-known problem of double taxation which has attracted world-wide attention, and has formed the subject of a series of conferences held under the auspices of the League of Nations. Chapter XIII attempts to make use of available income-tax statistics, in drawing certain conclusions regarding the economic condition and progress of the Indian people during the last 45 years and more. The concluding chapter briefly reviews Government's income-tax policy, and contains a summary of the main changes in the Indian Income-Tax system proposed by us. If the publication of this work results in the creation of an intelligent public opinion on the subject of income-tax, and if it helps to create in the country a well thoughtout and popularly backed scheme of income-tax reform, the author would regard his labour as well rewarded. There is, however, one point to which he would like to draw the reader's attention. Several of his proposals mean an increase of taxation; these are necessary to create justice in the incidence of our tax system; but before the people of this country press for the adoption of these proposals they should be certain that the money so raised would be spent for nation-building purposes, and not on the already expensive essential services.

CHAPTER I

THE PERIOD OF EXPERIMENT, 1860-1886

INTRODUCTION

It may be asserted that, like the introduction of the study of the English language in Indian education, the introduction of Income-Tax in the Indian financial system is one of the few happy heritages of British rule in this country. To a contemporary of John Wilson who first introduced the tax in 1860 or of Lord Lytton who refused to sanction its reintroduction in 1876,[1] such a statement would have seemed the apex of human absurdity; to us it seems a mere statement of fact. To appreciate such a radical alteration in the public attitude, we must study the history of the Indian Income-Tax from the date of its inception to the present day.

In discussing the history, we can conveniently divide it into the following three parts :—

I. The Period of Experiment 1860-1886
II. The Period of Integration 1886-1916
III. The Period of Legislative Consolidation 1916-1928

Before the permanent introduction of income-tax in the Indian financial system, direct personal taxation was the subject of prolonged experiments by the Government of India. As a result of these experiments, they found such taxation to be an indispensable part of their general scheme of public finance; at the same time, their doubts as to the exact form that such taxation should take were also finally dispelled. At the end of this period of experi-

[1] Strachey "Finances and Public Works of India", p. 194.

ment, Government decided to make income-tax a regular feature of the Indian financial system.

The second period deals with the income-tax of 1886, and its actual working for the next thirty years. In direct contrast to the period which preceded it, and—we may add—the one which followed it, the tax was left practically unaltered during the whole of this period. This rigorous absence of further legislation had a two-fold effect. On the one hand, it facilitated the smooth operation of the income-tax and built up a steady background for it, while on the other, Government gained valuable insight into its shortcomings and equipped themselves with the knowledge necessary for sound administrative reform. We may truly style this period one of integration, as, the Indian Income-Tax, recovering from the unanimous official and non-official obloquy it had received in 1873,[1] now secured an equally unanimous support.[2]

By the beginning of the third period, a wholesale re-examination of the fundamental provisions of the Indian Income-Tax had become overdue. Till then, financial necessity had been the only basis of income-tax legislation, and no attempt had been made to work out a rational and scientific basis for the tax. Government were aware of the situation, but the normal course of events was rudely disturbed by the advent of the War with its accompanying demand for more revenue. The income-tax was one of the first sources to which Government turned their attention. The rates of the tax were suddenly increased on a progressive basis in 1916, and this was followed two years later by an entire redrafting of the income-tax law. It was again recast in 1922, and since then, there has been a crop of amendments every year.[3] It is therefore but

[1] Vide Moral and Material Progress Report, 1873.

[2] See discussion in the Imperial Legislative Council on Government's proposal to introduce progression, F. S. 1916.

[3] From 1922 to 1927, there were no less than 13 amendments, Vide Sunderam's Law of Income-Tax in India, pp. 63-64.

appropriate to call this period one of legislative consolidation.

PERIOD OF EXPERIMENT

In no country in the world has an income-tax owed its origin solely to its power of restoring justice in taxation. It has mostly been the demand for revenue, not the need for justice, which has brought about its existence. India was no exception to this rule. When Her Majesty's Government in India proposed the levy of an income-tax in 1860, they did so not from an intelligent appreciation of its virtues as an equalizer of tax burdens, but because it would meet a part of the heavy demands created by the "Mutiny" of 1857. Accordingly, Mr. John Wilson, the English expert who had been sent to India to restore equilibrium to the Indian finances, proposed the levy of an income-tax and, following the English model, restricted its operation to a period of five years.

THE INCOME-TAX OF 1860

It will not serve any useful purpose to give a detailed description of the provisions of the Income-Tax Act of 1860, as, since then, much water has flowed under the bridges of the income-tax system in this country. We may, however, summarise several interesting features that characterised this maiden attempt :—

(a) Income was classified into the following four schedules, *viz.*, income from Landed property, from Professions and trades, from Securities and from Salaries and pensions; and the tax was imposed separately under these parts.

(b) The exemption limit for the general public was fixed at Rs. 200 per annum. As contrasted with this, the limit was Rs. 4980 for military and police officials, and Rs. 2100 for naval and Indian marine officers.

(c) Agricultural income was also subjected to the tax. Such income in the case of cultivators was assumed to be one-third of the rent value of their land. Thus cultivators of land the rent value of which was less than Rs. 600 were exempted from income-tax.

(d) The rate of the tax was 2 per cent. for incomes below Rs. 500, and 3 per cent. for incomes above that amount. The latter incomes really paid 4 per cent., as they had to pay an additional 1 per cent., the revenue from which was utilised for public works.

Returns of income were required from all who were liable to taxation, with the assurance that they would be taken into account in the assessment of income-tax. The assessee was allowed to appeal against his assessment within a specified period of time, failing which, he had to pay the tax assessed on him. Except in the city of Calcutta, practically no new administrative agency was created, the working of the tax being left in the hands of the land revenue officials.

WORKING OF THE INCOME-TAX OF 1860

The system of compulsory returns proved a dismal failure. To a people just recovering from the Mutiny, with the memory of British excesses fresh in their minds, the demand for personal returns of total income seemed to be but the first stage of an organised attempt at wholesale confiscation. It is not surprising, therefore, to find that "the returns were as a rule conspicuously and shamelessly false".[1] They were so entirely untrustworthy as to mislead rather than guide the assessors in making assessments. The Government, therefore, decided to suspend the clause relating to returns, and extended the operation of the assessments for the year 1860-61 to the succeeding year. The provision was found so convenient

[1] Moral and Material Progress of British India—1860-61 Part II, p. 105.

that it was renewed for a further period of three years. Government thus openly acknowledged the weakness of their assessing machinery, and by taxing industrial and commercial income in 1864 on the basis of their assessment four years before, reduced the income-tax to a farce.[1]

In 1862, the exemption limit was raised to Rs. 500 per year. Assessees with incomes below that amount had numbered 60 per cent. of the total, while their contribution amounted only to 20 per cent. of the total amount. They contributed less and cost more to collect.[2] The change was therefore quite salutary, and as a matter of fact made little difference to the total collections.[3]

A year after this, the Government reduced the rate of the tax from 4 to 3 per cent. The tax itself was allowed to expire in 1865.

THE LICENSE AND CERTIFICATE TAXES

India was without direct taxation only for one year after the expiry of the income-tax. The financial position worsened again and the Government were compelled to revive direct personal taxation. But the income-tax was not re-imposed, as the Government preferred the License-Tax with its much less troublesome methods of assess-

[1] This resulted in injustice to Government servants who paid the tax on their actual income while others paid it on their income as assessed in 1860. Thus the percentage of tax contributed by Government servants showed a steady increase.

1860	14.1
1861	15.1
1862	19.4
1863	20.3
1864	21.1

Based on figures compiled from Appendix 15, S. C. 1873.

[2] Cf. Samuel Laing "Now a tax which affects 6,00,000 persons to produce £3,50,000 gross, of which at least £1,00,000 is absorbed by cost of collection, is condemned by the mere statement of figures"—F. S. 1862-63.

[3]

Year	No. of Assessees.	Revenue in lakhs of Rupees.
1861	10,55,351	186.7
1862	3,44,630	157.6

nent. Accordingly, a license-tax was imposed on all industrial and commercial incomes which exceeded Rs. 200 per year. Assessees were divided into five classes, the lowest class consisting of persons with incomes between Rs. 200 and Rs. 500, and the highest class consisting of persons with incomes above Rs. 10,000. The lowest class paid Rs. 4 and the highest Rs. 200. Government servants were taxed on the same basis as trades and professions, but their exemption limit was Rs. 1,000 a year. Military officials got their usual higher exemption. Joint stock companies were placed in a separate class, the maximum tax payable being Rs. 2,000. [1]

This tax lasted only for one year, being replaced by a certificate-tax in 1868. This was a more comprehensive kind of license-tax, with a higher exemption limit and a sharper gradation of rates. Incomes below Rs. 500 were exempted, while incomes above that amount were divided into ten classes, the lowest (those below Rs. 1,000) paying Rs. 8 and the highest (those above 4 lakhs) paying Rs. 6,400. The average incidence of the tax was $1\frac{3}{4}$ per cent. Government servants were taxed at a uniform rate of one per cent. The exemptions continued as before.[2]

The chief importance of these taxes in relation to income-tax history lies in the fact that for a long time they were serious rivals to the adoption of income-tax in India. The license-taxes appealed to the Government chiefly because they involved relatively less inquisitorial methods. As a matter of fact, they had expressed their preference for this kind of tax as early as 1861.[3] Mr. Samuel Laing

[1] For further information see F. S. 1867-68. Also M. M. P.—1873-74.

[2] Cf. M. M. P. 1873-74; also F. S. 1868-69, and Sunderam's "The Law of Income-Tax in India", Appendix I.

[3] "Experience is quite sufficient to show that as regards the numerous classes who are required to send in returns and whose income cannot be ascertained without inquiring into their private incomes, it would be

had echoed it in one of his financial statements. The experience obtained by them in the working of these taxes convinced them of the superiority of the method of "classes and fixed fees" over that of "rate varying with income", especially in the case of the lower incomes. This experience was utilised in the framing of the income-tax of 1886.

Though these taxes were thus convenient from an administrative point of view, they were not popular. Landholders and fundholders were unnecessarily exempted, and further, government servants were treated with undue leniency. There were even demands for a reintroduction of income-tax.

THE SECOND INCOME-TAX, 1869-1873

Financial difficulties compelled Government to replace the certificate-tax by an income-tax; this change, however, did not adversely affect the persons who were paying the former tax; it only extended liability "to those sections who are now exempt".

This tax was not, truly speaking, an income-tax at all, for it was not based on the original percentage rates. On the other hand, it retained the system of "Income classes and fixed fees" which formed so salient a feature of the certificate-tax. While companies and salaries were taxed at 2 pies per rupee, individuals were divided into classes and paid fixed fees, varying from Rs. 6 on an income of Rs. 500 up to Rs. 1,140 on an income of Rs. 1,10,000 with Rs. 100 extra for every additional

a great improvement if means could be devised by which they might be assessed at fixed rates under a scale of licenses on a system more resembling that of the trade taxes in the Oudh and Punjab, which have been carried out there so successfully and with results not only more satisfactory to the people but more productive to the revenue than have attended the application of the corresponding provisions of the Income-Tax in other Governments". Financial Despatch 63, to the Secretary of State, 1861.

Rs. 10,000. The effective rate on the minimum of each class was thus a little over 1 per cent.

The exemptions were practically the same as those in the Act of 1860 with this exception, that under the new Act, Government servants lost their original privilege of a higher exemption minimum. Moreover, the original provision for compulsory filling in of returns was dropped. Further, the rate of the tax was now fixed in terms of so many pies per rupee instead of percentages.

Six months after the passing of the Act which fixed the rate at 2 pies in the rupee, Government felt that a further increase in revenue was necessary to avoid a deficit; they therefore raised the rates to one and a half times of those previously scheduled.[1]

In 1870, the rates were further raised to 6 pies in the rupee. This unstatesmanlike measure was adopted in the face of fierce opposition, in spite of the fact that no clear case had been made out for an addition to the revenues.[2] This increase was accompanied by the abolition of the system of income classes and fixed fees (except in the case of incomes below Rs. 2000), and the application of a uniform rate to the individual's income.[3]

The anticipated deficits having turned into realised surpluses, the Income-Tax Act of 1871 raised the exemption limit to Rs. 750, simultaneously reducing the rate to 2 pies in the rupee. The limit was raised to Rs. 1,000 next year. The Act expired in 1873 and was not renewed.

THE FAILURE OF THE INCOME-TAX

Government's decision not to renew the Income-Tax in 1873 was hailed with joy and relief by both the official

[1] Sunderam's "The Law of Income-Tax in India", Appendix I.

[2] Vide Appendix, S. B. C. C. 1869-70.

[3] Sunderam's "The Law of Income-Tax in India", Appendix I.

and non-official communities.[1] For a period of five years following this decision, the Indian financial system was without a direct personal tax.

The income-tax had thus proved an undoubted failure during this period of experiment.[2] We shall now attempt to discuss the different causes that led to this failure.

CAUSES OF FAILURE

The causes of this failure can be conveniently classified under the following two heads :—

I. Avoidable causes.

II. Unavoidable causes.

By avoidable causes are meant those which could have been avoided with proper foresight and statesmanship on the part of Government. By unavoidable causes are meant those which could not be helped, because they were inherent in the circumstances and conditions under which the income-tax was first imposed.

AVOIDABLE CAUSES

The following are the four such causes which led to the failure of the tax :—

(1) Temporary nature of the tax.
(2) Addition to the rates in 1869.
(3) Inclusion of Agricultural incomes.
(4) Absence of proper administrative machinery.

The first factor to mar the successful operation of income-tax in India during this period was its essentially temporary character. Indeed, "ever since the days of

[1] In the M. M. P. of British India, 1873, we came across references to a memorandum submitted by collectors and others—in reply to a government questionnaire—whole-heartedly condemning the Income-Tax. In spite of all efforts we have not been able to obtain access to that document.

[2] When proposals to renew the income-tax were made in 1878, the Viceroy dismissed them as impracticable and the Secretary of State declared his decision to withhold his assent to any such revival. Cf. Strachey's "Finances and Public Works of India", p. 194.

Mr. Wilson license-taxes have succeeded income-taxes, ertificate-taxes have followed license-taxes in various orms and shapes, and each in turn has been abandoned hrough an entire absence of any settled continuity of dministration in our finances".[1] If income-tax had been ntroduced on a permanent basis, it would have been ollowed by a gradual decrease of popular opposition, and he public would have eventually come to regard it as a ecessary evil. Instead, it was enacted, repealed and hen re-enacted, thereby rousing public discontent.[2] This accillating policy not only made the tax unpopular, but lso impaired its efficiency because accurate assessments ould not be made in such a short period marked by such brupt changes.[3]

The second cause was the sudden addition to the rates f the tax in the middle of the financial year 1869. This nheard of procedure on the part of the Government was regarded by the people as a breach of faith. No appeals were permitted against the assessment in spite of the ncrease in rates ; this naturally created resentment among the assessees, who had not cared to dispute the assessment earlier on account of the low rates. Reports from ll districts lay considerable emphasis on the widespread discontent that this act gave rise to.[4] And the discontent

1 Rivers Thompson, quoted in Strachey's "Finances and Public Works of India", pp. 207-208.

2 The Government of India in a letter to the Bengal Chamber of Commerce admitted that these changes were a source of great perplexity to the more illiterate classes "who were also harassed by the want of fixity in the rate, by the low limit of taxable income and in some cases the misconduct of the assessing agency". Appendix H, B. C. C. 1890.

3 This fact is recognised in an official document. "It is doubtful whether an income-tax could even be properly assessed unless it was continued and carefully worked out during a long series of years". M. M. P. 1871-72. Also cf. Sir John Strachey "No agency could be perfect under such constantly recurring changes".—Finances and Public Works of India, p. 208.

4 Vide Income-Tax Administration Reports, Lower Provinces and North-West Provinces, 1869 and 1870.

gave rise to indignation when the revised estimates for the year exposed the alleged justification of financial urgency. It was but natural then that public opinion condemned its continuance and welcomed its abolition in 1873.[1]

The third cause was the inclusion of agricultural incomes among those liable to income-tax. Whatever may be the arguments of the present-day economist in favour of this procedure, it was certainly not justified by the then existing circumstances. Land had already a heavy share of taxation, while trading and commercial incomes escaped scot free. To tax landed incomes, while taxing commercial incomes by income-tax, was taxing them again, and in the absence of graduation in the income-tax, clearly constituted double taxation. This created great discontent and, if the report for the year 1870-71 on the administration of income-tax in Lower Provinces is to be believed, inflicted a great deal of hardship on a large number of poor cultivators. This factor undoubtedly contributed to the failure of the tax.

The fourth and most important cause was the absence of a proper administrative machinery. The importance of proper administrative machinery in the successful working of an income-tax cannot be overestimated. It has been clearly proved by Seligman that in the absence of such machinery even the theoretically best of taxes may easily degenerate into an oppressive and unequal levy. That was the reason why the British system combined the democracy of local institutions with the bureaucracy of central supervision.[2] No such scheme was introduced in

[1] See evidence of Lord Lawrence before the East India Finance Committee, 1873.

[2] Cf. "The General Commissioners and the assessors were, in a certain sense, representatives of the tax-payers and might naturally be supposed to defend their legitimate interests against the Treasury; while on the other hand, the necessary degree of Government control was represented by the Surveyors and Inspectors who were responsible to the Central Government. This ingenious

India. The Government had an All-India machinery ready at hand *viz.* the regular administrative staff of the districts who had, among other tasks, also the collection of land revenue. They were now conveniently entrusted with the assessment and collection of income-tax as well. Except in the Presidency towns where special officers were appointed to administer the Act, the assessors were generally deputy collectors of long standing. The provision for compulsory filling of returns had been dropped by 1869, so that the assessors had now to rely on their own judgments in making the assessments. They toured the districts and this was considered sufficient to enable them to know the incomes of persons resident therein. They were assisted by no other machinery, for there was nothing in the Indian procedure corresponding to the General or Additional Commissioners of the English system. The Collector, who was the nominal assessing head, had his work carried out for him by the Deputy Collector, who in turn was assisted by his subordinate revenue staff. The value to be attached to this assistance can be inferred to some extent from the very interesting evidence of Mr. Kazi Shabuddin before the East India Finance Committee. Mr. Shabuddin as a Tahsildar, also happened to be the collector of income-tax in his taluka. But he had not much difficulty in making assessments. "The process was simple enough. I hardly knew anybody in the Pergunnah, so that all I did was to send for the village accountants and patels and give them the schedules which they filled in and sent to me. The patels and village accountants no doubt took advantage of this to favour their friends and harass others. I was obliged just to send on those schedules to the Collector."[1] No attempt was

combination of local representatives and of Government officials is found, with some modifications, in the present income-tax". Seligman's "The Income-Tax", p. 82.

[1] Qs. 8735-8740 S. C. See his further evidence "The tax was very unequal in its operation. Those who could evade it did so; others who

made to test the accuracy of the returns ; and Mr. Shabuddin asserted that "The Mamlatdar had so much to do that even if he attempted it, he could not make the enquiries". Such was the basis on which the Collector framed his assessments.[1]

The assessment, therefore, was largely arbitrary. One would, therefore, expect the provisions for appeal to be at least liberal. Facts were otherwise. Appeals against the Deputy Collector lay to the Collector, his next executive head ; and against the Collector, to the Commissioner. The judiciary had no power to decide questions of fact ; there was no machinery corresponding to the General Commissioners of the British system ; the Collector was not subject to any disinterested appellate body. It was as if the prosecutor and the judge were combined in one person.

The system was thus justly summed up. "The tax is in the nature of a benevolence or aid and the Collector is the almost irresponsible estimater and fixer of the quota which each man had to pay".

Such a procedure naturally caused popular opposition. To the charge of arbitrariness was also added that of oppressiveness, the operation of the Act being in the hands of subordinate and minor officials who levied extra legal charges and raised the assessment of those who were not in their good books.[2] "That these subordinates were in many cases corrupt cannot be doubted and there are numerous cases reported in which persons falsely assumed

had no friends or who were not on good terms with those who were in power had to pay an almost ruinous tax". cf. Letter from Collector of Gorruckpore to Board of Revenue "It is possible for a very painstaking tasheeldar, possessed of some conscience and a great deal of *prestige* in his jurisdiction so to keep his putwarees in hand that gross relative misassessments be not made". Income-Tax Report N. W. Province 1870-71.

[1] Even the air of local knowledge was a myth, no Collector being kept for long in charge of the same district.

[2] Q. 9587. S. C. 1871.

the title of Ameen or Collector of Income-Tax, travelled about the country taking bribes, on the pretence that they would arrange to have all persons who paid them exempted from the tax.[1] It was even reported that there occurred cases of suicide "which were attributed by the local authorities to excessive dislike of the income-tax or rather of the inquiries occasioned by the income-tax".[1]

The chief fault of Government lay in failing to realise the importance of proper machinery in the success of the income-tax. Not only did they fail to provide a whole-time and expert machinery, but they also entrusted its operation to the overworked land revenue staff who handled it clumsily, because they knew little about it.

UNAVOIDABLE CAUSES

The following are the three unavoidable causes of the failure :—

(1) Absence of industrialization.
(2) Novelty of the tax.
(3) The alien and undemocratic nature of the ruling authority.

One of the more obvious lessons to be learnt from the history of income-tax in the world is that it turns out to be a success only if the country, where it is applied, is fully industrialized. Large fortunes and great inequality of incomes are rarely the result of a pursuit of the agricultural profession; they are largely the accompaniment of an industrial civilisation.

[1] Evidence of Samuel Laing, Qs. 7674-7675—S. C. 1872. Cf. Mr. Inglis, Member of the Board of Inland Revenue, U. P. "Though only one in 300 paid income-tax to Government, he was afraid that of the remaining 299, at least one half was subjected to vexation, oppressive inquisition and extortion on account of the Tax". The Lieutenant Governor commenting on Mr. Inglis' observations admitted that they were "To a very considerable extent well founded". Quoted by Prof. Myles. Minutes of Evidence, Taxation Enquiry Committee Vol. IV, p. 114. Also cf. Vakil's Financial Developments in Modern India—p. 383.

If we remember this truism we can easily explain the financial failure that the first Indian income-tax proved to be. The India of 1860-1873 could hardly boast of any industry run by machinery. There were few, if any, concerns organised on a large scale. Nor was Indian agriculture based on large scale farming. There was little scope for the growth of large incomes, and hence the amount realised by income-tax could not be large either.[1]

The second factor which helped to bring about the failure of income-tax was its novelty to the Indian people. In the fierce controversy that ensued between the Madras Government and the Government of India as regards the imposition of income-tax, both parties dilated largely on its indigenous nature, one side holding that it was wholly Indian, the other that it was wholly non-Indian.[2] While it was true that during the pre-British days, there had been assessed taxes in India—taxes on houses and establishments, the product of land and the profits of trades—the idea of a tax, levied on the individual's *total* income and varying with its magnitude, was undoubtedly foreign to the people. Such a tax had no precedent in tradition; its inquisitorial processes were widely resented; and the people that had just recovered from the "Mutiny" suspected the *bona-fides* of the Government and feared confiscation.

But the antipathy had nothing racial in it; to say, as Sir Charles Trevelyan did, that the tax was "unsuited to

[1] Cf. Vakil's "Financial Developments in Modern India"—p. 380.

[2] *e. g.* Sir H. B. E. Frere "Altogether I doubt whether there is any part of India where an income-tax and taxes on arts, trades and professions are as much of a novelty as the income-tax was in England when revived by Sir Robert Peel: certainly there is none where such taxes are as new to the people as the income-tax was in England, when first proposed by Pitt as a regular part of his financial system". Quoted in Kale's "Dawn of Modern Finance in India", p. 95. On the other side, Sir Charles Trevelyan asserted that, "When the orders came from Calcutta for levying the income-tax, it was much as if an avatar of one of their malignant deities had imposed a new strange instrument of torture". Q. 898, S. C. 1873.

the low state of morality of an Asiatic people"[1] was sadly to misread history. If at all the history of income-taxation proves anything, it is this—that the tax is never popular when first imposed and needs decades of continued existence to accustom the public mind to its necessity, much less its merits.[2]

The third factor which went far to reduce its yield was the fact that in India the Government was neither national nor democratic. Even in a free and self-governing country like England, income-tax based on personal returns had proved a failure; it is not surprising therefore, that it did not succeed in India. The average assessee did not understand why he should pay the tax; at the same time he did not take a very personal or kindly interest in the Government whose coffers it went to enrich. Voluntary assessments were hence foredoomed to failure.[3] The result was a considerable loss of revenue, the Collector's judgment being no adequate substitute for the certainty that would have been obtained from correct returns. This factor also encouraged evasion by lending it a semi-halo of patriotic fervour.

CONCLUSION

Though the income-tax proved a failure in India during the early stages of its operation because of the causes

[1] Q. 896—S. C. 1873.

[2] Seligman gives an interesting account of the controversy following the imposition of income-tax in Great Britain and the long air of temporariness that hung around it almost till 1873 and Mr. Gladstone's 'bribe' to the voters.

[3] "This income-tax based upon the principle of self-assessment is unsuited to a people who are not united to their Government by a strong tie of national interest. A foreign rule can never be popular in this sense. Voluntary assessment without the stimulus of a strong personal interest in the Government to be supported is not likely to be very productive". Q. 896. S. C. 1873. Also cf. Sir Bartle Frere "The demand on a great multitude of people ill acquainted with the objects and usages of our Government in requiring them to tax themselves, by stating the amount of income on which they are to be assessed, was more calculated to puzzle and irritate than to reconcile them to the new impost". Kale's "Dawn of Modern Finance in India", p. 107.

mentioned above, the question naturally arises—was the abolition of the tax in 1873 a desirable and necessary step or had the tax proved its right to an honourable place in the Indian financial system?

It is difficult for the modern historian to reconstitute the past in its entirety; if one refers to contemporary opinion one meets with a chorus of condemnation. Three Finance Members in succession condemned the tax.[1] The officers who worked it disliked it; the people hated it. And yet, if the causes of failure are closely analysed one is led to the conclusion that the factors which made for its failure were more avoidable than otherwise; and under better circumstances and with a more statesmanlike attitude on the part of Government, the tax would have proved. comparatively speaking, a success.

Even the causes which we grouped under the head "unavoidable" were so only under those circumstances. Novelty could not have been a permanent handicap as continued existence would have dispelled it. Progress of time would have brought about industrialization, while recent events hold out hopes of a democratic government. Thus these three "unavoidable" causes were not permanent in their character, while the others could have been avoided by due foresight on the part of Government.

The way in which Government almost criminally whetted the people's distaste for the tax by insisting on

[1] "I think it is about as bad and obnoxious a mode of raising revenue as it is possible to imagine in a country like India". S. Laing. Q. 7643. S. C. 1873.

"What I object to is the establishment of the income-tax as an ordinary part of the fiscal system in India". Sir W. Massey. Q. 8582, S. C. 1872.

"An income-tax based upon the principle of self-assessment is unsuited to India." Sir Charles Trevelyan agreed that no Income or License-Tax can be so adjusted as to give satisfaction or not create such dissatisfaction as it is undesirable to make use of them. Qs. 896 and 908 S. C. 1873. It may be incidentally noted that Sir Charles owed his recall from the Governorship of Madras to his open and emphatic opposition to the introduction of the tax.

its temporary character,[1] the lack of foresight which they showed by creating a tax to work which they did not create a competent machinery, combined with their unstatesmanlike use of the tax as an elastic factor of the budget—all these made the tax unpopular and led to its failure. Given a permanent Income-Tax, with a sufficiently high minimum of exemption, moderate rates, exemption of agricultural incomes and an efficient administrative machinery, there was no reason why, with the progress of time, the tax should not conquer the natural aversion felt for a new tax, and come to occupy a decided, though inconspicuous, place in the finances of India.[2] To us who can look back with the wisdom of years, the unpopularity of the tax seems only temporary. It had been tried and had proved its worth.

THE LICENSE-TAXES, 1878-1886

Government, however, thought otherwise. When Sir John Strachey's new famine policy brought with it a necessity for new taxation in 1878, the income-tax was not reimposed. On the other hand, license-taxes on the earnings of trades and industries were introduced in all the provinces. These taxes were not instituted by central legislation but owed their existence to the different provincial governments.[3] By 1878, license-taxes were levied in all the provinces of India with the exception of Assam and British Burma.[4]

[1] Cf. the emphatic assertion of Sir John Strachey "If any plan of direct taxation is to become successful, the fast-and-loose system which has hitherto been followed must be abandoned". Finance and Public Works of India, p. 207.

[2] "I think that if they fixed at a moderate rate of, say, 3 per cent. and did not increase it and kept it as a source of revenue and took great care to see that it was not abused and if such an arrangement were made whereby there was no excessive extortion, the tax would not be so unpopular as it was". Lord Lawrence, Q. 5589, S. C. 1873.

[3] Act II. (1878), India, applying to Punjab and N. W. Provinces; Bengal Act I of 1878; Bombay Act III of 1878; Madras Act III of 1878.

[4] M. M. P. 1880-81, p. 29.

These license-taxes were not mere license duties, but essentially limited income-taxes on non-agricultural income, the agriculturists having been held to have contributed their share through the cesses levied on land.[1] "The tax payers are, for the purposes of the assessment divided according to their presumed incomes, into classes, all persons included in one class paying the same tax."[2] The scale was so arranged that the tax never exceeded 2 per cent. on the annual profits of the assessee.[3]

There being no central legislation on the subject, details of the tax varied widely in the different provinces. The minimum of exemption, for example, was not the same, being Rs. 200 in the case of North-West Provinces, Oudh and Madras, while in Bengal, Bombay and the Punjab, the limit was Rs. 100. This glaring anomaly was remedied in 1880, the Government of India standardizing the minimum of exemption at Rs. 500. This reform still left some provincial variations unaffected, as can be seen from Major Baring's complaints.[4] In North-Western Provinces, Oudh and the Punjab, there were two classes divided into 8 grades; in Bengal, there were 6 classes; in Madras and Bombay there were 8 and 11 classes respectively. Even the maximum tax payable was not the same, being Rs. 200 in Bombay, while it was Rs. 500 in the other provinces.

Moreover, the tax was levied only on earnings from trade. It did not apply to incomes from Government service, professions, and securities. This exemption could claim no justification.[5] Even with regard to the

1 Vide Sir A. Colvin's speech introducing Income-Tax Bill, 1886.

2 M. M. P. 1881-82.

3 Cf. "The so-called license-tax is in fact a limited income-tax assessed on a system of classification according to approximate income". Finances and Public Works of India, Strachey, p. 197.

4 M. M. P. 1881-82.

5 Cf. Fawcett. "Professional and official incomes are entirely exempt. The Governor-General with £ 25,000 a year, the officers in the Army, the well-paid civilians, successful barristers and doctors do not contri-

incomes to which the tax applied, there was no equitable sharing of burdens. In the same grade, the assessee with the lower income paid at a higher rate, while the one with bigger income paid at a lower rate; further, fixing the maximum at Rs. 500 led to a progressive regressiveness in the rate for incomes beyond Rs. 25,000.[1] The commercial community both Indian and European, had frequently complained of its uneven incidence. The Government admitted the validity of their complaint and introduced in 1879 a Trade and Profession-Tax Bill (No. XVIII of 1879) which extended the tax to official and professional incomes at the rate of 1½ per cent., and steepened the scale of rates payable by the trading classes;[2] the bill was, however, withdrawn,[3] and the reform was postponed till 1886 when an income-tax replaced these license-taxes.

In view of these defects, the license-taxes did not prove very successful in their working. They yielded about Rs. 50 lakhs per year and the amount was collected without much friction.[4] In 1880, the Government of India invited the opinions of the several local Governments as to the desirability of continuing the license-taxes.[5] The reply of the provincial governments is instructive in regard to the general desirability of direct

bute a farthing to the tax, but it is levied from every "petty trader and every handicraftsman, although their scanty earnings may amount to no more than 4 sh. a week". Fawcett's Indian Finance, pp. 125-28.

1 "It presses most heavily on the poorer among the trading mercantile and commercial class, and leaves the wealthier besides other whole classes of the upper part of the population comparatively or absolutely unassessed".—Sir A. Colvin, introducing the Income-Tax Bill—1886. Also cf. "The License-Tax was grossly unfair in its incidence. The big fish broke through while the small were caught in the net".—Mr. Steel, Council Debates on Income-Tax Bill, 1886.

2 See Appendix B, B. C. C. 1879-80.

3 "From causes which need not be stated in detail the proposal was dropped". Strachey Ibid. p. 204.

4 *Vide* Strachey, Ibid, pp. 202-203.

5 The replies of the various local governments are summarized on p. 29. M. M. P. 1880-81.

taxation in India. With the exception of the Madras and Bombay Governments,[1] the several local authorities were unanimously agreed that :—

1. The doubt and uncertainty produced in the minds of the people by frequent changes in the modes of taxation were far greater evils than the taxes themselves.
2. That any objections which originally existed on account of the pressure of the license-taxes on the poorer classes were met by raising the minimum assessable income to Rs. 500.
3. The people were becoming accustomed to the tax and collections had been much improved.

Their reply was not only an implicit condemnation of the vacillating policy of the Government during the period 1860-73, but also pointed the way towards the introduction of a permanent income-tax with an exemption of Rs. 500.

THE PERIOD AS A WHOLE, 1860-86.

We have now seen the progress of direct taxation in India, how it varied between Income-Tax and License-tax, and how all the while there was no continuity of policy. In spite of an impending deficit Sir Charles Trevelyan allowed the tax to expire in 1865. It was again abandoned in 1873, against the will of Lord Lawrence. There was a lull and then again in 1878 direct taxation was renewed.

The experience of the Government of India convinced them that direct taxation had come to form a necessary complement of their revenues, and could hardly be given up without seriously disturbing their finances.[2] At the

[1] The Bombay Government preferred any other form of direct taxation, while the Madras Government regarded the tax as unsuitable for imperial purposes.

[2] This factor gained further strength, when in 1882 the Government instituted a policy of Free Trade and thus voluntarily reduced their revenue from indirect taxation.

same time, equity and justice required that the trading, official and professional classes, who prospered most under British rule should be made to pay; and direct personal taxes were the only means of making them do so.

There were only two forms of direct taxation. License-Taxes, though successful from an administrative point of view, were thoroughly unjust and unequal as between different classes. Income-Tax, on the other hand, satisfied all theoretical requirements of equity, but the inquisitorial methods it employed were universally disliked and excited much discontent. These inquisitorial enquiries were especially in evidence in the assessment of smaller incomes, and in the assessment of agricultural incomes. By 1878, Government had discovered another method of tapping agricultural incomes, while the license-taxes pointed out the way to avoid unpleasant inquiries in the case of smaller incomes. Government thereupon hit on a via media between the Income and License-Taxes; *viz.* a tax that would be an income-tax proper for incomes above a certain level, but would only be a license-tax for incomes below that amount. Thus, they could obtain the advantages of both the Income and License-taxes without their respective disadvantages. The Income-Tax of 1886 was the direct result of this experience.

The period of experiment, then, was not without fruitful results. It had enabled the Government to arrive at a type of direct taxation, that was at once just and not very inquisitorial; and consequently it enabled them to incorporate direct taxation into the financial system of the country, with good hopes of its becoming its permanent—though not predominant—part.

In the following chapter, we shall proceed to survey the Income-tax which came into being as a result of this experimental stage, and carry on the story of its history till the introduction of the principle of progression in 1916.

CHAPTER II

The Period of Integration, 1886-1916

We have seen in the preceding chapter how Government had finally come to accept direct taxation as an indispensable part of their financial system. The License-Taxes, however, were inequitable in their incidence, and contributed only a small amount to the exchequer. The Income-tax, on the other hand, distributed tax-burdens in an equitable manner being at the same time capable of yielding more revenue. It only required a pressing necessity for additional finance to usher the Income-Tax into existence. That opportunity arrived in 1886, when government found itself faced with a deficit of £2,000,000. Accordingly, the License-Taxes were repealed and replaced by an income-tax on non-agricultural incomes.

THE INCOME-TAX OF 1886

The proposed Income-Tax continued the desirable features of the License-Taxes. The taxable minimum was left unaltered at Rs. 500. Incomes below Rs. 200 continued to be taxed on the old method of income classes and fixed amounts, the regular rate of 5 pies in the rupee being levied only on incomes above that amount. In truth, the Income-Tax of 1886 was not an introduction but "an enlargement, extension and equalization of direct taxation". In spite of the efforts of the Indian members of the Council, the tax was not restricted to a particular period, thus differing notably from the previous income-taxes.

THE SCOPE OF THE TAX

The tax was not properly speaking an income-tax, firstly, because it excluded agricultural incomes from its scope; and secondly, because it was levied not on an individual's 'total' income but on his different 'sources' of income. For this purpose, the Act classified all income into the following four schedules :—

(1) Salaries and Pensions;
(2) Profits of Companies;
(3) Interest on Securities;
(4) Other sources of Income.

The tax was imposed separately on each without reference to the others, *e. g.* if an individual had an income of Rs. 400 under "Salaries" and Rs. 400 under "Interest on Securities", instead of being taxed on Rs. 800, he was totally exempted, as under each separate schedule his income was below the taxable minimum. In other words, income was divided into a number of water-tight compartments, and the Income-Tax of 1886 was therefore really a series of schedular taxes levied under the authority of one Act.

BASIS AND COMPUTATION OF ASSESSMENT

The nominal basis on which the tax was levied was the income accruing during the year of assessment. As a matter of fact, this was only true in the case of income taxed at source. As regards other income, the previous year formed the real basis of assessment, though it was held equal to the income of the 'present year'. The Act contained no provision as regards the computation of income, but executive instructions enumerated the deductions allowable from gross income in computing it for purposes of income-tax. These were not entirely uniform in all the provinces, but the following were the chief items allowed :—

(1) Repair charges,
(2) Insurance charges,
(3) Rent of premises used for the business,
(4) Wages,
(5) Bad debts,
(6) Interest on money borrowed for purposes of the business.

EXEMPTIONS

Incomes below Rs. 500 were exempt from the tax. But this exemption was not absolute as persons with incomes above that amount were not given a corresponding deduction. In the case of military officials however, the exemption limit was Rs. 6000. The law authorised the following further exemptions :—

(a) Agricultural income.[1] As we have already seen, agricultural income was excluded from the scope of Income-Tax as having been already taxed by the local cesses levied on land in 1878.
(b) Such portion of the income—not exceeding one-sixth—as would be spent for securing a deferred annuity or a life insurance.[2]
(c) Profits of shipping companies.
(d) Interest on stock notes.[3]

[1] The incomes exempted under this head were :— Income from land subject to land revenue or local cess, and used for agricultural purposes; also income derived by the cultivator from processes rendering the produce ready for the market, as well as from the sale of such produce; also income derived by rent received from buildings which are in the immediate vicinity of the land and are required as a dwelling house or a store house or factory or out-building.

[2] Such a deduction did in no way remove liability to the tax or alter the rate where such liability originally existed, e.g. if a person had an annual income of Rs. 500, he could not claim total exemption from the tax on the ground that deducting the life-insurance charges, his income amounted to less than Rs. 500.

[3] Stock notes were an interesting experiment made by Government at encouraging small investors. They were Government securities of Rs. 10, 25, 50 and 1000 bearing 4 per cent. interest and issued at par. They were legally exempt from all taxation. Vide Vakil. Ibid. pp. 299-300.

RATES OF THE TAX

The rate of the tax was 4 pies in the rupee for incomes below Rs. 2000, while it was 5 pies for incomes above that amount. The graduation was thus elementary, and existed only as regards incomes below and above Rs. 2000.

For Part IV, however, there existed a special arrangement as regards incomes below Rs. 2,000. These were the incomes most difficult to assess as the smaller traders and businessmen kept no regular accounts and could not give accurate returns of their income. Yet they had been subject to the License-Taxes ever since 1878 ; and the experience of those eight years demonstrated to Government the superiority of levying fixed amounts from them over the practice of assessing them on a strictly income-tax basis. It was therefore decided to continue the same arrangement as prevailed under the License-Taxes, but only so far as incomes below Rs. 2,000 were concerned. The scale of rates was as under :—

Income	Fee	Percentage of Tax to Income
	Rs.	
Between Rs. 500 and 750	10	1·3
,, 750 and 1000	15	1·5
,, 1000 and 1250	20	1·6
,, 1250 and 1500	28	1·9
,, 1500 and 1750	35	2·0
,, 1750 and 2000	42	2·1

This system not only did away with the need for very accurate assessment, but also introduced some element of graduation for incomes below Rs. 2,000.

ASSESSMENT AND COLLECTION

The method of deduction at source was employed in the case of interest on securities, and salaries and pensions, so far as they were paid by Government and Local Authorities. There was no such compulsory deduction in the case of salaries paid by companies and private employers, but provision was made for arrangements between the collector and the employer by which the tax could be deducted in return for a commission.[1] In addition, all employers had to notify to Government the number of persons in their employ, their salaries and their addresses.

As regards companies, the principal officer had to submit a return of net profits, but was not liable to produce his accounts in support of the same.

The visible and easily accessible sources of income were those which came under Parts I, II and III. Part IV included just those incomes—commercial, manufacturing, trading and professional profits—which it was very difficult, firstly to locate, and secondly to assess accurately. It was in the assessment of incomes under this schedule that the Collector found his hardest task.

The Collector could invite returns of income from all persons chargeable under Part IV but was not authorized to enforce their production.

THE ASSESSING MACHINERY

A close study of the Income-Tax Manual, 1886, brings out the fact that though the Collector was the nominal assessing head, the Mamlatdar or Tahsildar was the chief pillar of the system. This revenue officer acted as the Income-Tax Deputy Collector for his division and attended to the assessment and collection of that tax. He

[1] The commission varied, being 4 per cent. of tax proceeds if paid in a lump sum, 3 per cent. of tax proceeds if paid quarterly and 1 per cent. of tax proceeds if paid monthly.

was generally assisted by one or more assessors appointed by the Government.

Subject to the Collector's approval, the Deputy Collector framed detailed instructions for the assessors, and a scheme of operations for their circles. Each assessor was furnished with a complete list of villages within his circle and also one of persons who had been liable to the repealed license-tax of 1880. He was also required personally to hold local enquiries in order to verify the correctness of the list, and to prepare a revised list for assessment under the new act. In this task, the subordinate revenue staff were directed to give him the full benefit of their experience and knowledge. The assessor had then to submit his statement and returns to the Income-Tax Collector at headquarters. After proper scrutiny, and revision, if necessary, the deputy collector had to send on these returns to the Collector's office.

THE REGISTER OF ASSESSEES

On the strength of the information thus obtained, the Register of Assessees was to be prepared at the Collector's office. This register contained details of income and tax payable per different assessees, but was open for public inspection only as regards those whose incomes were less than Rs. 2,000. It could be divided into parts covering entire villages and these parts were to be posted on the village post office or police station. It was also published in the local vernacular newspapers. Along with the register, there were notices inviting persons mentioned therein either to pay the tax specified against their names within sixty days of the posting of the notice, or appeal within thirty days of the same.

Similar rules for payment and appeal were enforced as regards persons with incomes above Rs. 2,000, with this difference that they had to be sent special notices of assessment by the Collector.

Thus though the Collector was nominally the supreme pillar of the system, his work was largely carried out by his subordinates. The assessor looked after incomes between Rs. 500 and Rs. 5,000 and the Deputy Collector those between Rs. 5,000 and Rs. 10,000, and the Collector personally minded incomes above Rs. 10,000.

As regards incomes accruing to occupying owners from house property, the tax was to be levied on 5/6ths of the gross annual rent at which it may reasonably be expected to let. It was provided that this assessment shall not exceed 10 per cent. of the owner's income from all sources.

REVISION AND APPEAL

Appeals against assessments were to be made to the Collector before the date specified in the notice. The Collector could hold the hearing at any time and place he liked, and the assessee had to subordinate his own convenience to that of the Collector.

Corresponding to the division of labour in the assessment of income, there was a similar sharing of the work of revision. The assessor was permitted to hear appeals against tax assessments of less than Rs. 42. Appeals against the assessor lay to the sub-divisional officer. The Income-Tax Deputy Collector was the next superior, being authorized to deal with objections to assessments. As regards assessments above Rs. 250, the Collector himself heard the objections. The appellate authority above the Collector was the Commissioner, but appeals relating to amounts of less than Rs. 250 could be entertained only at his discretion. No Civil Court had the power to entertain a suit to set aside or modify any assessment made under the Act. The administrative machinery was therefore entirely supreme in the matter of assessment, revision and appeal.

RISE IN THE EXEMPTION LEVEL, 1903

Before proceeding to survey the working of the tax during this period, we may note one important change in its provisions introduced in 1903. In that year, the exempt minimum was raised from Rs. 500 to Rs. 1,000 per year. This tardy response to insistent public demand greatly relieved the lower middle classes who had been hard hit by the former level. A fuller account of this Amending Act is given in Appendix I.

WORKING OF THE INDIAN INCOME-TAX, 1886-1916

We shall now examine the tax in its actual operation under the following sections :—

(a) Scope of the Tax.
(b) Work of Assessment.
(c) Revision and Appeal.
(d) Public opinion and the Tax.
(e) Yield of the Tax.

THE SCOPE OF THE TAX

We have seen how the tax was nominally very extensive in its scope, being based both on 'origin' and 'residence'. But when it came to a matter of practice, it was much restricted. The principle of origin—which had laid down that all income arising or accruing in this country shall be liable to its income-tax—was the one to be most violated.

Soon after the passing of the Act, salaries, pensions, and leave allowances paid by the Government of India to persons resident in Great Britain were exempted from Indian Income-Tax.[1] A few years later, railway employees were granted the same concessions with regard to their leave allowances drawn in England.[2] It was

[1] G. I. F. C. No. 2101 of 28th April 1887.

[2] G. I. F. C. No. 6028-S. R. of 6th December 1901.

further extended in 1909, to employees of private concerns[1] as "a matter of grace".

Under Part III, interest on the sterling securities of the Government of India, though obviously arising in India—as they formed a part of the well-known "Home Charges" remitted year by year from the Indian Treasury—was not liable to the Indian Income-Tax. They were ruled by the law officers of the Crown to be technically not Indian Securities,[2] and the Government therefore desisted from taxing them.

Under Parts II and IV, we can find similar cases of exemption in favour of income arising in India, but remitted to or received in England. The South Bihar Railway Company made an arrangement with the Secretary of State under which they received a fixed rental in London in lieu of net receipts from the working of their lines in India. Their income was held to arise in England and therefore not taxable in India.[3] In addition to this special case, non-resident firms consigning goods for sale in India through resident agents were not taxed on their profits from such transactions, the sole ground for such exceptional treatment being the difficulty of ascertaining their incomes.[4]

The scope of the tax, therefore, was not so extensive in practice as it was in theory. As we have seen incomes arising in India but receivable in England, were largely exempted from the Indian Income-Tax.[5]

Further, the exemption of agricultural incomes made

[1] G. I. F. D. No. 4994—Exc. of 14th October 1909 quoted in Bombay Income-Tax Manual—pp. 81-82, also of Bengal Triennial Reports 1908-11 and 1902-05.

[2] F. S. 1916—Debates.

[3] Bengal Triennial Report, 1902-05.

[4] The proposal to tax them met with strong opposition from the European Chambers of Commerce. Appendix H, B. C. C. 1890.

[5] Thus in practice, the principle of 'residence' played a predominant part especially so far as the incomes of non-resident Englishmen were concerned.

the extent of liability very vague and indefinite. Contradictory rulings were issued as regards the liability of rent derived from land, but collected and appropriated by a money-lender in return for interest due to him.[1] In a similar way, while sugar factories were subject to the tax on the ground that the processes they employed were not those "ordinarily employed by the cultivator for rendering the produce fit for the market", tea-plantations were exempt even on their manufacturing profits. Thus in practice, the tax tended to be vague and restricted in its scope.

WORK OF ASSESSMENT

The assessment of incomes under Parts I and III presented little difficulty, as the tax was deducted at source in the case of Government servants and security-holders, while in the case of employees of private concerns the Collector made similar arrangements with the employers.[2] As regards Part II, companies had to submit compulsory returns of their profit, though not liable to submit their accounts. As most of the companies had their principal place of business situated in the big cities, they were assessed by the special income-tax officers of those places and consequently there was not much difficulty in assessing their incomes.

The Part, which gave the greatest trouble so far as assessments were concerned, was the one which was the most productive.[3] This was Part IV which consisted of

[1] Bengal Triennial Report, 1899-1902.

[2] Where such arrangements were not made, there was a certain amount of under-assessment. Cf. "It was brought to light towards the close of the triennium that several persons in one district who received very large salaries and allowances paid little or no tax whatever." U. P. Triennial Report 1924-1927.

[3] "The objections are almost entirely against assessments on trades and professional incomes under Part IV of the income-tax Schedule", p. 88, M. M. P. 1888-89.

'Other Sources of Income'. This vague phrase included—

Professional incomes,
Industrial and Commercial incomes,
Incomes from house property,
Incomes from other unspecified sources.

Doctors, lawyers, money-lenders, merchants, house-owners, industrialists—these formed the persons whose incomes the Collector had to ascertain, and in this task he received no help from the assessees themselves. Returns of income were not compulsory and even when submitted were "traditionally and notoriously nebulous".[1]

No new administrative machinery had been created to work the tax. The executive staff of the district, who worked it, were not persons chosen on their special competence to administer the tax. Their chief task was the collection of land revenue and the preservation of law and order; the assessment and collection of income-tax formed only a subsidiary part of their functions. The consequences were twofold. Firstly, these officers were overworked, and had neither the time nor the energy to devote themselves to the accurate assessment of income.[2] Secondly, even with all the good intentions in the world, they could not accomplish much. They were neither trained in accounts, nor equipped with the special knowledge by which alone commercial or industrial income can be accurately ascertained. So that, even where the accounts were submitted, they were of little use as a basis for the assessment, as these officers were incompetent to examine them.[3]

1 Punjab Triennial Report, 1908-11.

2 Cf. "We are told again and again in most of the Provincial Reports on the Income-Tax that the district staff or even the Talooka staff is either too busy or too tired for the income-tax to work". Indian Income-Tax by Pagar, pp. 105-106.

3 Their helplessness is clearly revealed in the following extract. "In fact the assessing officer arrives at the conclusion that the leading members of certain sections of the community are or ought to be liable

This shows that the assessing officer had neither the time nor the abilities to assess accurately the incomes of assessees.[1] At the same time, his task was rendered more difficult, for the assessees were illiterate and did not keep accounts on a scientific basis.[2] Nor was it safe to base assessments on standards of living, as these were determined largely by the social status and traditions of the assessee, and not by his income. The result was that the work was amateurish and conducted on a 'rough and ready basis'; the assessments were nothing more than guesses on the part of the Collector.[3]

We shall now notice a few of the devices employed by the revenue officers in supplementing their meagre resources and trying to arrive at a true picture of the incomes of assessees. The methods adopted were mainly three :—

to tax, but is uncertain as to the class in which he should place their income". This was pre-eminently due to the absence of special training. Decennial Report, M. M. P. 1881-1891, p. 273.

1 "The Deputy Commissioners generally held that the Tahsildar has neither the training nor the time for this work—the work is carried on on an amateur basis and there is little prospect of the Tahsildar going beyond his rough and ready methods of assessment". Punjab Triennial Report, 1914-17. The district staff, however, were not without excuse. Cf. "The assessment for income-tax in a country where compulsory returns of income cannot be enforced and where personal expenditure is no criterion of wealth presents great difficulties". Decennial Report, M. M. P. 1892-1902.

2 Cf. "The task of assessing such incomes may be compared to the problem which would confront the officers of Inland Revenue in England if they were required to assess a number of traders, ranging in status from an icecream vendor to a Provincial banker and keeping their accounts in Norman French written in Black Letter on easily detachable slips of parchment", Punjab Triennial Report, 1908-11. Sometimes, the accounts were too scientific. Cf. "In numbers of cases among the trading classes in many parts of India, the system of bookkeeping adopted bears direct reference to the preclusion of the information from the cognisance of any but the trader himself and those whom he has had to initiate into the mysteries of his accounts". M. M. P. Decennial Report, 1881-91, pp. 268-269.

3 "The Collector never really ascertains the income. It is impossible to do more than make a guess". Assam Triennial Report, 1917-20. Also cf. "Our present system or rather absence of system of assessment is in the majority of cases under Part IV neither more or less than a futile groping in the dark"—Punjab Annual Report, 1914-15.

(a) Assessment by Commissions,
(b) Assessment by Groups,
(c) Assessment by Special Officers.

ASSESSMENT BY COMMISSIONS

Under this method, the Collectors issue 'Commissions' to certain selected persons, authorizing them to go through the accounts of some of the assessees, mainly those with commercial or industrial income.[1] Those 'selected persons' were generally themselves in the trade and had a working knowledge of accounts. The assessment was based on the result of their enquiries. But the very factors that ought to have made for its success became responsible for its failure. If these persons had the advantage of local knowledge and standing, they had also the disadvantage of having their sympathies in favour of the assessees, as against the Revenue. Where they were not swayed by sympathy, they were not proof against being deceived by bogus debits and other allied methods.[2] This system, therefore, could not prove a successful solution of the knotty problem of accurate assessment.

ASSESSMENT BY GROUPS

The idea of assessment by groups originated with Lt.-Colonel Young, the Deputy Commissioner of Sialkot,

[1] "The issue of commissions to private individuals for the examination of the accounts of bankers and traders is a necessary portion of our administering the Act. It is really the only way in which returns of income made by those carrying on business on any but the smallest scale can be checked, because there is no official agency available for the purpose". Financial Commissioners in the Punjab, Triennial Report, 1902-05.

[2] "It is undesirable that too much weight may be attached to accounts and even if the man appointed to make the examination of the accounts is perfectly honest, he may be deceived by bogus debits and other methods.......The men appointed to examine accounts are necessarily tradesmen or traders' agents themselves, and instinctively sympathise with those whose accounts they were examining". Deputy Commissioner of Karnal in Punjab Triennial Report, 1902-05.

and was first tried in his district. It is consequently known as the "Sialkot System".

In cities, assessees were divided into groups according to their trades or professions; in rural tracts the groups were constituted by reference to localities instead of to trades and professions. The Collector fixed the total assessment on every group, the collective assessments of individual assessees being the basis in each case; the general prosperity of a trade or of business and agriculture in a particular tract were also taken into account in such a determination of the total assessment.

Once the assessment was thus fixed, the whole group of assessees was summoned. They could not alter the total figure, but were permitted to exclude any old assessee or include any new ones. A small committee was then selected which apportioned the assessment between the members of the group. Objections were then invited, the whole group having collectively to decide whether to accept the objections in whole or in part. If any individual assessments were reduced, the Special Committee had to re-distribute the amount thus reduced over the remaining taxpayers in the group. After carefully considering the distribution of liability made in this manner, the Collector announced his assessments.[1]

The scheme was certainly not unattractive, promising, as it did, to secure an ideal distribution of the assessment. On the advice of the Financial Commissioner, the Lieutenant Governor ordered its extensive adoption in the Punjab.[2] It was tried in 15 districts, but did not meet with much success, being finally given up as unworkable in the very district of its birth,[3] Sialkot.

[1] Appendix, Punjab Annual Report, 1912-13. In case of objections after the final announcement, the group committee had to render its assistance in disposing of them.

[2] Punjab Triennial Report, 1911-14.

[3] Punjab Annual Report, 1915-16. Also cf. resolution of the Lieutenant Governor of the Punjab, Triennial Report, 1914-17.

We may now analyse the causes of its failure. First, the scheme was in no way superior in accuracy so far as total assessments were concerned. To find out the income of a group was certainly not easier than to find out the income of its individual members ; as a matter of fact, the former was supposed to be based on the latter. In the determination of the total assessment, then, the Collector received no outside help. His assessments, therefore could not be accurate as he had neither the time nor the special ability needed for such a purpose.

Second, the scheme did not prove a success even as regards distribution. The Panchayats or the 'Interior Committees', while perfectly willing to order remissions, were reluctant to propose increases. They did not possess the confidence of the trades either, for they displayed a strong tendency to overassess the poor to the benefit of the rich.[1]

In short, the system, though moderately successful in parts where the Panchayats were not too selfish, could afford no adequate solution of the problem of securing accurate and definite information about the income of assessees.

ASSESSMENT BY SPECIAL OFFICERS

The third device adopted to bring about accuracy in assessment was the appointment of special officers with special establishments—including an accounts clerk—to revise the assessments in selected towns and cities. These men were full-time officers, engaged solely in income-tax work. They carefully went through the assessments of the places assigned to them, examined accounts, and supplemented their knowledge by searching enquiries into the personal circumstances of the assessees. From the results of their enquiry, the officers would then revise the

[1] Punjab Annual Report, 1912-13; also Punjab Triennial Report, 1914-17.

assessments. This not only increased revenue, but also made the tax more equitable, many persons who had been unjustly assessed being now excluded on more careful examination.[1] The system ensured a generally reasonable basis for the assessment and in consequence, appreciably lessened the unpopularity of the tax.[2] The use of full-time and expert agency was thus found to have the most beneficial results, and clearly foreshadowed the coming order.[3] In addition to this inaccuracy, they were found

1 A typical example is the special agency employed under Pandit Girdhari Lal for assessment in particular areas in the Punjab. "Apart from the increase in the assessment of old assessees, 355 new cases were detected in Lahore, yielding an assessment of Rs. 34,982 and 624 new cases in Amritsar, yielding an assessment of Rs. 40,494. The advantage of the operations were not limited to the increased assessments secured. The burden has also been adjusted more equitably; small men who ought not to have been included in the assessment lists have been removed from them in the light of the fuller knowledge obtained and friction has been reduced to the minimum". Punjab Triennial Report, 1914-17.
Also cf. "It has been decided to employ an expert staff for the survey of income-tax and the examination of accounts......its employment should do much to secure a full revenue to Government, substantial assistance and relief to district officers, and among the people more confidence than at present exists in the thoroughness and fairness of assessment". C. P. Triennial Report, 1914-17.

2 Punjab Triennial Report, 1908-11. Also cf. "It is reported that as a result of the improved methods of assessment, assessees now show a greater readiness to pay the tax than in former years when assessments were based on less thorough and sometimes rather haphazard enquiries, a circumstance which gave rise to discontent among those assessees who saw others richer than themselves escape with light or no assessment". Bombay Triennial Report, 1914-17.

3 Punjab Triennial Report, 1914-17. Also cf. "It is to the employment of special agencies, whether occasional or permanent or peripatetic that we have to look to improve the unsatisfactory features of Income-Tax Assessment". Punjab Annual Report, 1914-15.
Also "Assessing officers are quite incompetent to examine accounts or to check the examination made by any person appointed for the purpose. It might pay Government to appoint an auditor to examine accounts in the case of very large incomes". C. P. Triennial Report, 1914-17. "The Board have addressed to the Government separately asking for the provision of a full-time income assessing staff and the matter is under the consideration of the Government". U. P. Triennial Report, 1914-17.
The Board of Revenue, Madras "suggested inter-alia the employment of a staff of trained accountants to scrutinize and audit the accounts produced before assessing officers". Madras Triennial Report, 1911-14.

definitely partial to the richer assessees.[1] As a matter of fact, the Sialkot system failed on this very account.[2] As regards the ordinary agency, it was asking too much of a Tahsildar to expect him to assess rich men properly. He is inevitably afraid of the rich and influential, and also nervous of the suspicion of personal animosity or corruption.[3] The tax therefore fell with much greater sharpness on the poorer section of the assessees.

It is no wonder, then, that Income-Tax in India became extremely unpopular. The assessors were generally men of little standing and no reputation.[4] They were not well-paid and consequently were not above bribery,[5] and their activities had the effect of making the already low taxable minimum go down to a still lower level.[6] To make matters worse, cases were not found wanting of pretenders going about the country, black mailing the general public and extracting money by threats of assessment to income-tax.[7]

To sum up, the assessment was arbitrary and unequal in incidence. Various devices had been tried by which it could be improved; but they had not proved very suc-

1 "The ordinary agencies—busy with a hundred other more urgent jobs—take the line of least resistance, fight shy of the rich man and decline to release any of the small". Also cf. "It is in connection with this class that the operation of the impost requires most strictly to be watched". Decennial Report, 1881-1891, M. M. P. p. 173.

2 Punjab Triennial Report, 1915-16.

3 Punjab Annual Report, 1914-17.

4 "Evidence and accounts are rejected which do not square with the inspiration of that detectable knot of busy bodies—a necessary evil perhaps—inspirations which are too often the figments of fancy, safe against exposure because undisclosed". P. Ananda Charlu, F. S. 1902.

5 "Although the income-tax has been in force for a number of years, the inquisitorial methods which are in some cases adopted by ill-paid and corrupt assessors in the mofussil, renders it a highly unpopular imposition. I myself know of a case where a clerk employed in an income-tax office drawing not more than Rs. 30 a month has in a bank a big balance of some thousands which very discreetly is entered in the name of his wife". Maharaja of Darbhanga, F. S. 1897-98.

6 Cf. P. Ananda Charlu, F. S. 1902-03.

7 Bengal Triennial Report, 1899-1902.

cessful. The chief reason for this failure in the work of assessment was the absence of a full-time and well-paid administrative agency. Indeed, considering all the circumstances, it was really creditable that the tax was not much more unpopular than it actually was.[1]

REVISION AND APPEAL

When we come to the working of the tax in relation to appeals and revision, we are seriously faced with the problem of absence of material. Even as regards the work of assessment, we have been unable to secure all the triennial reports on the administration of income-tax in the various provinces—much less the annual reports. In the section devoted to Income-Tax in the "Statistics of British India" Part IV (b), there is no information about revision and appeal. The only figures we have been able to gather are obtained from Return No. V of the various Triennial Reports. From the figures so gathered and collated, we have worked out All India Tables. But, as already mentioned, all the reports were not available, and therefore the word 'All India' cannot be taken literally; it sometimes means three provinces, sometimes four or five and so on. Nevertheless, the figures are all comparable, because we have taken, not the absolute figures, but only percentages.[2]

No figures whatsoever, are available as regards the period 1886-99, except the percentages of successful appeals. If we take the later period, and start with 1903 (the year when the exemption limit was raised to Rs. 1,000), we find the following results :—

[1] We have devoted so much space to administrative considerations, because it is administrative efficiency alone which can result in an equitable Income-Tax. This element was conspicuously absent in the Indian System.

[2] For details see Appendix II.

QUINQUENNIAL AVERAGES

Period	Percentage of objections to total Assessees	Percentage of reduction of original Assessees to final assessees	Percentage of reduction of original assessment to final assessment
1903-1907	22·2	5	5·4
1908-1912	19·6	4·2	5·2
1913-1917	18·4	3·6	6·4

The table clearly reveals a noticeable tendency towards reduction in columns (1) and (2), and a less noticeable though evident reduction in column (3). The following inferences are plainly justifiable and throw great light on the work of assessment.

(1) With the progress of years, the tax was getting less unpopular and the work of assessment, less inaccurate.

(2) Though the administrative machinery was getting expert enough to locate people with incomes liable to tax, it was unable to locate their incomes with accuracy.[1]

Our conclusions as regards the growing efficiency of assessment are further supported by the figures of the percentage of successful appeals, given below.

PERCENTAGE OF SUCCESSFUL APPEALS—QUINQUENNIAL AVERAGES

1888-93	38
1893-97	35
1898-02	32
1903-07	22
1908-12	21
1913-17	20

[1] This was true of the earlier period as well. Cf. "In fact, the assessing officer arrives at the conclusion that the leading members of certain sections of the community are or ought to be liable to tax, but is uncertain as to the class in which he should place their income". Decennial Report, 1881-1891, M. M. P., p. 273.

We have repeatedly made the assertion—based on the results obtained in other countries—that however imperfect the administration of an Income-Tax might be at its inception, its continued existence leads to a better machinery. This is now corroborated by Indian experience. There could be no worse machinery to administer the tax than in India; yet, year by year, the work of assessment showed better results and the unpopularity of the tax decreased, if that can be judged by the figures of objections. This, however, in no way modifies the view expressed in the last section that fundamental defects made imperative the creation of a new machinery to work the income-tax.

Appeals against the Collector's decision were admitted by the Commissioner, but only when the tax exceeded Rs. 250, *i. e.* where the incomes assessed exceeded Rs. 9,600 a year. The Commissioner could, on his finding, raise or lower the assessment; as a matter of fact they were uniformly reduced, except in one year, (1906) when the assessments were increased by .5 per cent. above their original level. During the period, 1903-1916, the average percentage of reduction brought about by the Commissioner did not exceed .5 per cent. of the original demand, as contrasted with the Collector's 5 per cent. This, of course, was due to the fact that the number of appeals before the Commissioner was much smaller, being only 6 per cent. of those before the Collector; and it was therefore, no indication of any undue rigour on the Commissioner's part.[1]

To sum up, a large number of assessees took advantage of the provision for appeal that the law provided. And, so far as an assertion can be made on the available material, the Collectors seem to have acted quite fairly

[1] Even the appeals before the Commissioner show a persistent reduction. Quinquennial averages:—1903-07 ...... 6.6
1908-12 ...... 6.3
1913-17 ...... 4.7

in dealing with the appeals. The Commissioners, too, do not seem to have been unjust in discharging their appellate functions.[1] At the same time, the original assessments were not much reduced on revision, from which it might be inferred that the assessments were generally more or less accurate. An alternative explanation is that some of the assessees were underassessed and therefore refrained from appealing. The probably correct explanation is that the appellate authority had not any more material than the Collector to determine the justice of the assessments, while the ignorant assessee was quite unable to prove the amount of his income; the relative absence of any change in the final demand is to be traced to this cause, and does not indicate any general accuracy in the assessment.

PUBLIC OPINION AND THE TAX

There was a strong section of public opinion that vociferously demanded the abolition of the tax. They held that direct taxation was unsuited to the circumstances of the country and could not work in India; it was imposed in a time of emergency as a temporary measure and therefore, with the improvement of the financial position of the Government, should be immediately repealed.[2] The demand was confined not merely to some vocal members of the Imperial Legislative Council. The European Com-

1 As regards revision by Deputy Collectors and Tahsildars, no information is available.

2 "The income-tax is, in my opinion, quite unsuited to the circumstances of the country". G. R. Chitnavis, F. S. 1894, p. 95.
"The unsuitability of this country for the purposes of direct taxation need not be gainsaid". Maharaja of Darbhanga, F. S. 1897.
"No form of direct taxation is suited to our country". Rajah Durga Charan Laha, F. S. 1898, p. 89.
"It is entirely unsuited to the conditions of the country and of the people". Mr. Allan Arthur, F. S. 1899.
"Being entirely unsuited to this country by reason of the circumstances generally attending its collection and payment, it should not be regarded as a permanent source of revenue and its total abolition should be constantly kept in view". Sir Montague Turner, F. S. 1903-04.

munity also pressed vigorously for its abolition. The Bengal Chamber of Commerce in 1890, and the Bombay Chamber in 1903 submitted memoranda to the Government pleading for the repeal of the Tax. Their representative in the Council, while disclaiming any desire on the part of the mercantile community to shirk a fair share of its obligations, opposed the continuance of the tax as inquisitorial and unsuited to the country.[1]

The two stock arguments of the abolitionists were first, that the tax was levied for a specific purpose and with its removal, should be allowed to expire. Second, that it was unsuited to the circumstances of the country.

The first argument was based on absolutely false premises. Government gave no such guarantee, as was assumed by these people, of the early abolition of the tax. As a matter of fact, Government had stoutly opposed all attempts to make it temporary, and Sir Auckland Colvin's speech in 1886 clearly showed that he contemplated the permanent addition of the tax to the financial system. The second ground may be dismissed as too flimsy to be taken seriously. All taxation is unpopular, but direct taxation is more so, because it is more noticeable. There is nothing oriental or occidental in any individual's dislike for taxation. The dislike may be greater in the case of a people subject to an undemocratic and alien Government.

After all that could be said against the tax, it must be admitted that it was the only means of making the rich man contribute something even remotely approaching his proper quota to the revenues of the country. The income-tax undoubtedly made some efforts to adjust the incidence of taxation on a more equitable basis. Government rightly took their stand on this point.[2] The work of assess-

[1] F. S. 1904-05.

[2] "I look on the income-tax as an excellent source of revenue and I believe that it is most desirable that it should be continued. As years

ment was bound to improve with time; and an enumeration of defects proved the case not for repeal, but only for reform. Government therefore dismissed the plea for the total abolition of the tax as "quite outside the range of practical politics".[1]

While one school of Indian thought thus repeatedly and unthinkingly demanded the repeal of the tax, there was another which indulged in a more constructive criticism. They pointed out that the Indian Income-Tax was far from being perfect and stood in need of great reform. In this connection, the attention of the Government of India was drawn to the following defects :—

(a) The absence of abatements in the Indian system which made the tax press heavily on incomes just above Rs. 1,000.[2]

(b) Absence of differentiation.[3]

(c) Absence of uniformity in the rates of depreciation for machinery and buildings allowed in the various provinces.[4]

(d) Absence of any popular element in the Indian administrative machinery.[5]

Their complaints, however, were not very effective.

roll by, the methods of assessment should steadily improve and I trust that the tax will in course of time, perhaps with some modifications enable us to obtain some reasonable share of contribution towards the expenses of Government from an important class whom many think have hitherto escaped unduly lightly". Sir Edward Law, F. S. 1903-04. Moreover, the tax had now come to be accepted as "a necessary evil, undesirable, but not intolerable". Bengal Triennial Report, 1889-1902.

1 F. S. 1904-05.

2 "The Indian rate, without the moderating influence of the wholesome principle of graduated abatements, presses far more heavily on the Indian people than the English rate does upon the English people." Dr. Mukophadyaya, F. S. 1904-05. Also Nawab Kwajah Sahimullah, F. S. 1904-05.

3 "The incidence of the tax is the same whether the income is permanent, earned or unearned". Dr. Rash Behary Ghose, F. S. 1907-08.

4 Sir Sasson David, F. S. 1911-12 and Sir Vithaldas Thackersey, F. S. 1912-13.

5 In 1912, the Hon'ble Mr. Rama Ayyangar demanded in the Council that Government should take up seriously the problem of the association of non-officials in the assessment of income-tax.

Government occasionally admitted the existence of these defects; but deferred their consideration to the time when the tax would be thoroughly revised. This they undertook to do in the near future.

Public opinion, then, had by the end of this period, got itself accustomed to the existence of the tax. The demand for abolition was succeeded by the demand for reform. It only needed, as in 1886, the necessity for increased revenue to bring about the much needed revision.

YIELD OF THE TAX

Before we conclude our survey of this period, we must analyse the progress of the tax from the point of view of its yield. Appendix III gives in detail the figures of annual yield. Here we shall only reproduce the quinquennial average of such figures, as better indicative of the true success of the tax.

Period	Number of Assessees (in thousands)	Amount of tax (in lakhs of rupees)
1886-87—1890-91	400	148
1891-92—1895-96	456	172
1896-97—1900-01	496	191
1901-02—1905-06	357	196
1906-07—1910-11	268	226
1911-12—1915-16	319	276

The fourth quinquennial period 1901-02 to 1905-06 should be left out of consideration when considering the progress of the tax because during the earlier half of that quinquennium, the taxable minimum was Rs. 500, while during its later half, the exemption limit was raised to Rs. 1,000. Ignoring this period, then, the figures reveal a steady progress on the part of the tax. While the new exemption considerably reduced the number of

assessees, it was followed by no such corresponding reduction in the yield of the tax; on the other hand the tax shows a consistent increase throughout the period, the increase being particularly noticeable during the latter half of this long period.

CONCLUSION

The period 1886-1916 with which this chapter is mainly concerned, has been entitled "The Period of Integration". Following the experiments in direct taxation which the Government of India embarked upon, during the period 1860-86, they arrived at a final decision, and instituted an income-tax in 1886; from 1886 to 1916, this tax remained on the statute book, with but a few alterations. Its unbroken existence for 30 years was doubly useful. To the Government, it laid bare the defects that underlay the Indian system and showed the way to reform. In the people, it bred an intelligent, though gradual, acquiescence to the continuance of the tax. Before the end of this period, the tax became a genuinely integral part of the Indian Financial System; all talks of its abolition practically ceased, and both Government and the people could look forward to it for increased revenue and more equitable incidence of taxation. Indeed, the Income-Tax had obtained such firm support in India, and such public opinion had been created in its favour, that, when the war came, there was no opposition to the drastic changes it brought about in the Income-Tax System of our country. Even as the period of experiment afforded the proper basis for the inauguration of an Income-Tax in this country, similarly this period of integration furnished the real foundations for the sweeping reforms in the Income-Tax that have been introduced since 1916.

CHAPTER III

THE PERIOD OF LEGISLATIVE CONSOLIDATION, 1916-1930

The history of the Indian Income-Tax is brought up to date in this chapter and is followed by a brief description of the present position. We shall divide this chapter therefore into two parts :—

(a) Legislative Consolidation.

(b) The Present Position.

LEGISLATIVE CONSOLIDATION

As contrasted with the legislative lethargy of the preceding thirty years, the period 1916-28 is conspicuous for its numerous Income-Tax Acts. The movement started with the introduction of a progressive scale in 1916 ; it was succeeded by a wholesale alteration of the income-tax law in 1918 ; a famous ruling of the Madras High Court upset the fundamental conception of 'income', and following the report of a specially appointed committee, the law was put in a consolidated form in 1922. The legislature was not satisfied however, and every year has seen a crop of amendments being placed on the statute book.

The first change to be introduced was in 1916, the rates of the tax being raised for incomes above Rs. 5,000. In the following year, the Act was further amended, returns of income on the part of assessees being now made compulsory. But such piecemeal legislation could not solve the problem. There were more fundamental defects in the Act of 1886 which clamoured for early remedy. For example, the concept of income differed in different

parts of India, as its computation was governed by local procedure which resulted in confusion and want of uniformity ; at the same time, with the advent of progression, the old conception of income, which strictly differentiated it into different compartments, had become obsolete and created injustice even as between persons of equal ability to pay, e. g. if an individual A derived Rs. 10,000 wholly from one source, he paid tax on it at the rate of 9 pies in the rupee ; if another individual B derived an equal amount, but from two sources, say, in the proportion of Rs. 6,000 and 4,000 each, he paid tax on 6,000 at the rate of 6 pies and on the other 4,000 at the rate of 5 pies in the rupee. Thus, though A and B had equal total amounts of income, A paid Rs. 493-12-0, while B paid only Rs. 266-10-8. In other words, B was a gainer by Rs. 227-1-4 solely for the reason that his income was derived from more than one source. Considerations of equity demanded a thorough overhauling of a system that could create such a situation ; prudence also dictated a similar course, for without an improvement in its administrative provisions, the Income-Tax could not easily yield the larger revenue that the government expected from it. It became evident therefore that income-tax reform could not be postponed any further. The result was the repeal of the Income-Tax Act of 1886 followed by the enactment of the Income-Tax Act of 1918.

THE INCOME-TAX OF 1918

Without going into a full description of the provisions of this Act, we shall notice the more important changes which it introduced in the income-tax system of this country.

(1) The original conception of income as separated into watertight compartments is replaced by the concept of total income. The rate of the tax was henceforth to be

determined with reference to the individual's total income under all sources.

(2) The basis of computation was embodied in the statute and the connotation of 'income' was thus made uniform throughout the country.

(3) Some of the unjust exemptions allowed under the old Act, such as those granted to foreign shipping companies and military officials with incomes above Rs. 6000 were now disallowed.

(4) Returns of income were made compulsory. Income-Tax officers were also empowered to demand the production of accounts and other relevant documents; non-compliance resulting in a loss of the right of appeal. The task of assessment was thus greatly facilitated.

(5) Provision was made for the assessment of non-residents on their 'Indian' income. When such income was not accurately ascertainable, a statutory equivalent was provided.[1]

(6) The period of assessment was henceforward the current year. In practice, the assessee was first taxed on his previous year's income. If within the next year, either the assessee or the Government ascertained the actual income of the assessed year, either party could demand that this actual income should be made the basis of assessment. If this proved to be greater than the previous year's assumed income, the assessee paid to the state the tax on the excess; if the amount was less than the assumed income, the state refunded him the tax on the difference. This procedure was technically known as the "Adjustment System" on account of the adjustments involved.

RAISING OF THE EXEMPTION LIMIT, 1919

Within one year after the new Act was passed, the taxable minimum was raised from Rs. 1,000 to Rs. 2,000.

[1] The Income-Tax Officer was empowered to tax the non-resident at a reasonable percentage of the turnover of his Indian business.

This step was justified on the ground of the great rise in the level of prices which had followed the War and the consequent distress of the poorer middle classes.[1] While relieving about 181 thousand assessees or nearly 50 per cent. of the total number, the financial loss was only 6·2 per cent. of the total tax collected. It was therefore a welcome change.[2]

THE SUPER-TAX ACTS OF 1917 AND 1920

Super-tax is only another name for an additional levy of income-tax on incomes above a certain high level. The Indian super-tax was first introduced in 1917 and made applicable to incomes above Rs. 50,000. In addition to taxing individuals on their total income, the super-tax was also levied on the undistributed profits of companies, firms and Hindu undivided families.[3]

The mercantile community vigorously protested against the taxation of the undistributed profits of companies on the ground that it discouraged the building of sound commercial reserves and hampered business development. When a new super-tax Act was passed in 1920 this defect was removed, and the graduated super-tax on the undistributed profits of companies was converted into a flat super-tax on their total profits at the rate of one anna in the rupee. The exemption of those below Rs. 50,000 was however continued. Hindu undivided families and unregistered firms were now deprived of their

1 Vide Sir James Meston, F. S. 1919-20.

2 The actual figures are:

Year	Assessees	Tax Collected (Rs. '000).
1918-19	366,431	9,34,31
1919-20	185,791	8,76,24

Compiled from Table 115, Statistics of British India Vol. IV, Tenth issue.

3 They were also allowed to deduct from their income, liable to super-tax, one-tenth of their income as calculated for purposes of Income-Tax. This was a concession. In the case of Hindu undivided families the tax was applied only to that part of their income which was not distributed or finally allotted to their members. Super-Tax Act, 1917.

previous concessions without any corresponding compensation, and treated on the same lines as individuals. At the same time, the Act levied substantially higher rates on the bigger incomes.

THE INCOME-TAX ACT, 1922

The Act of 1918, however, did not survive for a long period. The theoretically perfect "Adjustment" system, which the mercantile community had forced on the Select Committee of 1918, was found unworkable in practice. It involved the keeping of a continuous account between the State and the taxpayer;[1] and while the taxpayer was ready to claim refund from the State in case his actual income was less than his assumed income, he was not so willing to pay when it exceeded his assumed income. It also created a sense of grievance on the part of the taxpayer and resulted in great discontent.

While the basis of assessment under the Act was thus showing itself in urgent need of reform, a peculiar judicial interpretation of the word "income" forced the hands of Government. A full Bench of the Madras High Court decided that income meant what 'comes in',[2] and nothing could be regarded as income unless it was actually received by the assessee. The business community however largely kept their accounts on a mercantile basis. They credited amounts due to them and debited amounts due to others. It was on that basis that they calculated their taxable profits. They were naturally upset by this interpretation of 'Income' which conflicted with their long practice. It was also felt that the legislation of 1918, a product of the War period, was undertaken rather hurriedly and that a thorough revision of the Income-Tax system would not be out of place. Government therefore

[1] Cf. "This continual see-sawing demonstrated the unsuitability of the Adjustment System now in vogue". Punjab Annual Report, 1920-21.

[2] Board of Revenue vs Arunachalam Chetty, Case 20, I. T. C.

ɔointed a committee to investigate into the whole ıblem of income-tax in India and report upon a pro- ;ed bill. The committee collected evidence from ambers of Commerce and other commercial bodies and ılly reported to the Government in 1921. The :ome-Tax Act of 1922 is based on their report.

Ɔuring the course of this and the preceding two .pters we have surveyed at length the history of taxes Income in India. As contrasted with many foreign ıntries,[1] India had been very fortunate in this respect t income-tax had been established here long before the ers had even dreamed of having it. Repeated ex- 'iments in direct taxation had sufficiently modified the to suit Indian conditions, and from 1886 it enjoyed an ɔroken tenure of existence for 30 years. When the ɪr came with its accompanying strain on the national ınces, this long existence of the income-tax stood it good stead. While other countries had hurriedly to ate a new tax and a new machinery, the Indian :ome-Tax, was ready to assume its natural function. became an engine of national finance. From the ıgnificant place it occupied in the Indian fiscal system 1913, the tax now assumed mighty proportions, and :raged to 12·6 per cent. of the total revenue during the 'iod 1922-26. Its yield was more than quadrupled hin four years,[2] while complaints against its existence

[1] Notably Belgium, France, Canada, Australia, South Africa and the United States of America all of whom introduced the "Income-Tax" *during the years 1913 to 1917.*

[2]

	No. of Assessees (in thousands)	Amount of tax collected (in lakhs of rupees)
1916-17 to 1920-21 (average)	323	1125
1921-22	271	2191
1922-23	271	1813
1923-24	286	1849
1924-25	294	1623
1925-26	297	1618
1926-27	304	1682

were at best half-hearted and without any public support.[1] The Indian Income-Tax has thus undoubtedly won its way into the Indian financial system.

THE PRESENT POSITION

We give below a brief description of the present position of income-tax law. The taxation of income in India is governed by the following authorities :—

(1) The Indian Income-Tax Act of 1922, as subsequently amended.

(2) Rules framed by the Board of Inland Revenue up to 1924, and thereafter by the Central Board of Revenue under section 59[2] of the Indian Income-Tax Act and published from time to time in the Gazette of India.

(3) Notes and instructions regarding Income-Tax Law and Rules issued by the Government of India as Part III of the Income-Tax Manual. (Volume I)

(4) Income-tax Case Law or the law as interpreted by judicial decisions.

(5) The rates of the tax are not embodied in the Income-Tax Act itself, but are fixed by the annual Finance Acts. This is meant to secure elasticity in the fiscal system, the rates being adjusted with reference to the annual budgetary requirements. But as a matter of actual practice, the rates have remained stationary since 1922.[3]

[1] As contrasted with the opposition in 1886, the Indian members of the Imperial Legislative Council declared themselves strongly in favour of the Income-Tax and congratulated Government on their introduction of graduation into the tax and some of them refused to hear any talk about its abolition. F. S. 1916.

[2] "The Central Board of Revenue may, subject to the control of the Governor-General-in-Council, make rules for carrying out the purpose of this Act and for the ascertainment and determination of any class of income".

[3] Cf. Sir George Schuster's second Budget (March 1930) in which the rates of income-tax were increased by one pie in the rupee uniformly for all incomes above Rs. 5000.

SCOPE OF THE TAX

All incomes arising, accruing or received in British India are liable to the Indian Income-Tax. In addition certain incomes are deemed to arise, accrue or be received in this country and are thus brought under the scope of the tax. Besides, the Act taxes the total incomes of the following entities :—

(1) Hindu undivided families.
(2) Companies.
(3) Firms.
(4) Other Associations of Individuals.

Exemptions :— The following are among the important classes of incomes exempted from the Indian Income-Tax :—

(1) Agricultural Income.
(2) Income of property devoted to religious or charitable purpose.
(3) Salaries and pensions payable outside India.[1]
(4) Interest on securities held by certain 'approved' provident funds.[2]
(5) Disability and war pensions.
(6) Casual gains and capital receipts.
(7) Life Insurance premiums not exceeding one-sixth of the assessee's total income.
(8) Income from tax-free securities.
(9) Income of local authorities.

Excepting companies and registered firms, the other assessees are liable to the tax only if their income exceeds Rs. 1,999 per year.

Computation of Income :—The basis of assessment under the Indian law is the previous year's profits. The

1 Interest on sterling securities is also exempt in practice; such incomes were not specifically exempted, as it was held that they were outside the scope of the Act and hence not taxable.

2 The provident funds thus exempted are those to which the Provident Funds Act of 1897 applies.

assessee has to pay income-tax on his income of the preceding year. The previous year of the assessee need not necessarily coincide with the Government Financial year which ends on 31st March. The basis of taxation is the profits of his previous accounting year. This normally consists of 12 calendar months,[1] but in accordance with the prevailing practice of the assessee, especially when his accounting period is a Hindu year, it may vary from eleven months to thirteen months.[2] Once the assessee has thus exercised his choice, he cannot change his decision except with the consent of the Income-Tax Officer.

There is no comprehensive treatment of net income as distinguished from gross income, though the permissible deductions are specified under each head. The general principle governing the scheme of deductions is first, that nothing in the nature of capital expenditure will be allowed to be set off against profits ; and second, that no expenditure shall be allowed as a deduction unless it is incurred solely for the purpose of the business.

Income from Salaries and Securities :— So far as salaries and interest on securities are concerned, the gross yield is generally equal to the net yield. But where it can be proved that money was borrowed specifically for investment in securities, the interest on such money is allowed as a necessary deduction.

It is only when we come to income from property and business that we find a sharp difference between gross receipts and real profits. The law, therefore, specifically lays down the deductions, that may be allowed in this case.

Income from property :—In computing income from property the following deductions are allowed[3]:—

1 Section 2 (II), Income-Tax Act, 1922.

2 Para 5, Part III, Income-Tax Manual.

3 Section 9, (i) to (vii, c) Income-Tax Act, 1922.

(1) Cost of repairs, not exceeding one-sixth of the annual value of the property.

(2) Annual premium paid to insure the property against the risk of damage or destruction.

(3) The amount payable by way of ground rent on mortgage charge, if any.

(4) Land Revenue paid in respect of the property.

(5) Collection charges not exceeding 6 per cent. of the annual value.

(6) As regards partly or wholly vacant houses such sums as the Income-Tax Officer may determine having regard to the circumstances of the case. This allowance is made only for houses which are usually let.[1]

It is also provided that the aggregate of these allowances shall not exceed the annual value of the property.

Income from Business :—Allowances under this head can be classified broadly under the three following groups :—

(a) Ordinary expenses of Production.

(b) Depreciation.

(c) Obsolescence.

Expenses of Production :—The expenses of production are necessarily incurred in the making of an income and are hence a just charge on the income. Amongst the specific items thus allowed are[2]:—

(1) Rent and repairs of business premises, also Municipal taxes.

(2) Interest on capital borrowed for the purposes of the business, provided its payment is not dependent on the earning of the profits.[3]

(3) Charges of insurance against risk of damage or

[1] Para 33, Notes and Instructions, Income-Tax Manual.

[2] Section 10, (1) to (9), Ibid.

[3] This proviso is meant to avoid loss of revenue by profits masquerading under the guise of interest.

destruction of fixed and circulating capital employed in the business.[1]

(4) The cost of current repairs.

Under departmental instructions, premiums paid for insurance against loss are allowed to be deducted, provided the assessee agrees to pay tax on the sum recovered on any such insurance.[2]

Depreciation:—Under the Indian law, depreciation allowances are granted in respect of buildings, machinery and plant owned by the assessee and used in his business. They take the form of a percentage on the original cost to the assessee, the rates being determined by the Central Board of Revenue. Details are furnished in Appendix No. IV. These allowances are granted only if the prescribed particulars are furnished by the assessee; and the aggregate of such allowances are not to exceed the original cost. If during any year there are no profits or gains, against which these allowances can be debited, the law provides for their being carried over to the succeeding years.

Obsolescence:—In addition to depreciating in value, machinery and plant also become obsolete. They have to be discarded or sold, to be replaced by improved substitutes. The expenditure incurred thereby is quite correctly charged to the income. The law partially recognizes this fact by making an allowance for obsolescence. The amount allowed is arrived at by deducting from the original cost of the discarded machinery the amount of its scrap value together with the depreciation allowance hitherto granted.

PERSONAL ALLOWANCES

Personal allowances of the type found in the west are singularly absent in India. Persons taxed under the

[1] Viz. :—Buildings, machinery, plants, furniture, stocks and shares.

[2] Notes and instructions, 42, Ibid.

Indian Act are individuals and Hindu undivided families. There is only one personal allowance in India, viz. :—Insurance allowance, which has been already described. The exemption from Income-Tax of persons, whose total incomes are below Rs. 2,000 is hardly an allowance, as the amount is not allowed as an abatement from incomes above that amount. It is only an exemption limit.

RATES OF INCOME-TAX AND SUPER-TAX

The rate of the tax is determined not by the taxable income of the assessee but by what is called his "Total Income". The latter means not only the income on which the individual is directly assessed but also that on which tax has already been deducted.[1] In addition to the income taxed at source, the total income includes the allowance for insurance, and in the case of Government Servants the deductions compulsorily made for provident funds.

The super-tax which is an additional rate of income-tax is essentially personal. It is levied on individuals, and unregistered firms with incomes above Rs. 50,000 and on Hindu undivided families with incomes of over Rs. 75,000. Super-tax on dividends of companies and profits of partners of registered firms is collected directly from the individual. Tax-free securities are not exempt from super-tax. Receipts from Hindu undivided families and unregistered firms are not taken into account in determining the rate of super-tax payable by the individual.

In the case of Income-Tax the rates are determined with reference to the total income ; in the case of super-

1 There is however one exception to this rule. The income received by members of Hindu Joint Families from the Joint Family are not included in their 'total income', as contrasted with the fact that they have to include income received from either a company or a firm.

tax the rates are determined on the successive doses or slices of income. The rates of the tax are given below :—

INCOME-TAX (RATES PER RUPEE)

	Before 1916	1916-20	1921	1922-30	1930-31
	Pies	Pies	Pies	Pies	Pies
1,000- 1,999	4	4	nil	nil	nil
2,000- 4,999	5	5	5	5	5
5,000- 9,999	5	6	6	6	6
10,000-19,999	5	9	9	9	9[1]
20,000-24,999	5	9	12	12	13
25,000-29,999	5	12	12	12	16
30,000-39,999	5	12	16	18	19

SUPER-TAX (RATES PER RUPEE)

Income grade	Before	1916-20	1921	1922-30	1930-31
		as.	as.	as.	as.
First 50,000	nil	nil	nil	nil	nil
Next 50,000	nil	1	1	1	$1\frac{1}{12}$
Next 50,000	nil	$1\frac{1}{2}$	$1\frac{1}{2}$	$1\frac{1}{2}$	$1\frac{7}{12}$
Next 50,000	nil	2	2	2	$2\frac{1}{12}$
Next 50,000	nil	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{7}{12}$
Next 50,000	nil	3	3	3	$3\frac{1}{12}$
Next 50,000	nil	3	$3\frac{1}{2}$	$3\frac{1}{2}$	$3\frac{7}{12}$
Next 50,000	nil	3	4	4	$4\frac{1}{12}$
Next 50,000	nil	3	4	$4\frac{1}{2}$	$4\frac{7}{12}$
Next 50,000	nil	3	4	5	$5\frac{1}{12}$
Next 50,000	nil	3	4	$5\frac{1}{2}$	$5\frac{7}{12}$
Next 50,000	nil	3	4	6	$6\frac{1}{12}$

There is a super-tax also on companies but this is levied at a flat rate of one anna in the rupee and only on profits above Rs. 50,000.

[1] The rate for incomes between Rs. 15,000 to Rs. 20,000 was 10 pies in the rupee.

ASSESSMENT AND COLLECTION

The assessment and collection of the tax is effected in the following ways :—

(1) Deduction at source.
(2) Taxation at source.
(3) Direct assessment on the individual.
(4) Presumptive assessment.

Deduction at source :—This means a system under which whoever pays the income is compelled to deduct the tax thereon. Under the Indian law, deduction of tax at source is made compulsory in the case of two heads of income, viz. salaries and interest on securities. In the case of salaries, the rate at which the tax is deducted is the one appropriate to the assessee's total income solely on the basis of his annual salary ; in the case of interest on securities, deduction is to take place at the maximum rate.

Taxation at source :—Though firms are legal entities and hence taxable, their income is really enjoyed by a number of persons, and it is these partners of firms or shareholders of companies who really pay the tax. In other words, individuals are taxed at the source on their income from firms and companies.

So far as the methods of assessment are concerned, firms and companies are treated in no way different from individuals. They have to submit returns of their income [1] and can be called on to produce their accounts ; [2] failing compliance, they can also be taxed at an amount determined as 'fair' by the taxing officer. [3]

The only difference in procedure is with regard to companies. The principal officer has to submit the return

[1] *Section* 22 (*1*), Income-Tax Act, 1922.

[2] Section 22 (4), Ibid.

[3] Section 23 (4), Ibid.

before the 15th of June every year and no special notice calling for the same need be sent to him.

Direct Assessment :—This is the method of assessment which is employed in the majority of cases ; because unlike his income from salaries and securities, an individual's income from business, which is the most important source, is known only to himself.

The procedure adopted for direct assessment is as under. The Income-Tax Officer has to send notices to all individuals—who he thinks are liable to the tax—asking for returns of their income[1] in the prescribed form. Within a month of the receipt of the notice, persons to whom such notices have been sent are to submit their returns—whether they are liable or not. If the officer thinks that certain points in the return need elucidation or require proof, he can call upon the assessee to present himself at his office and explain the return.[2] He can also call for the accounts of the assessee,[3] summon witnesses and take evidence.[4] If the return is accepted as correct, the assessment must be based on that return. But where neither accounts nor returns have been submitted, the officer is to make the assessment to the best of his judgment. This does not mean, however, that he can substitute the rule of thumb for the rule of law ; he has to act in a judicial spirit and make the assessment on available evidence.[5]

Presumptive Assessment :—Two factors have given rise to what may be called presumptive assessment of income, where the income is legally calculated on some fixed formula. These two factors are first, the complexity of modern income, and second, the fact that especially in the case of non-residents, the necessary records might be beyond the reach of Indian jurisdiction.

1 Section 22 (2), Ibid.
2 Section 23 (2), Ibid.
3 Section 22 (4), Ibid.
4 Sections 37 and 38, Ibid.
5 Cf. Sunderam's Law of Income-Tax.

The following classes of income are assessed on a presumptive basis :—

(1) *Income from house property* :—This is declared to be its bona fide annual value, the sum at which the house is reasonably expected to be let from year to year.[1]

(2) *Life Insurance Companies, Indian* :—In the case of those companies incorporated in British India which carry on life assurance, annuity, or capital redemption business and whose profits are periodically determined by actuarial valuation, it is provided that their income shall be the average annual net profits disclosed by the last preceding valuation. But if in arriving at such actuarial valuation, any deductions are made from the gross income that are not admissable under the Income-Tax Act, they are added to the net profits and then taxed.[2]

(3) *Life Insurance Companies, Non-Resident* :—In the absence of more reliable data the income of Indian branches of non-resident insurance companies (Life, fire, marine, accident, burglary, fidelity guarantee, etc.) may be deemed to be a proportion of the total profits of these companies corresponding to the proportion which their Indian premium bears to their total premium income.

(4) *Shipping Companies*[3] :—In the case of non-residents who carry on shipping business in British India, the law provides that before departure from any British Indian port, the master of the ship shall file a return of the full amount received by way of freight charges. The Income-Tax Officer after ascertaining the accuracy of such return shall assess the profits of the business at 5 per cent. of the receipts.[4]

(5) *Mixed Incomes*[5] :—In the case of incomes derived

[1] Section 9 (1), Income-Tax Act, 1922.

[2] Rules 25, 26 and 35, Income-Tax Manual.

[3] These provisions apply only where there is no agent of the principal from whom the tax can be recovered.

[4] Section 44-B, Ibid.

[5] Rules 23 and 24, Ibid.

in part from agriculture and in part from business, the income assessable to the tax is the total income as diminished by the market value of the agricultural produce. Market value is given a statutory meaning. It is calculated according to the average price at which the agricultural produce is sold during the year previous to that of assessment. But where the agricultural produce is not usually sold in its raw state, the market value will be the aggregate of the expenses of cultivation, the land revenue, and a reasonable rate of profits—as fixed by the Income-Tax Officer—on the scale of such produce. In the case of income derived from the growth, manufacture and sale of tea, these rules do not apply ; and 40 per cent. of the total income is deemed to be the profits of manufacture.[1]

(6) *Incomes of Non-residents*[2] :—Where the Income-Tax Officer is of opinion that the actual amount of income accruing to non-residents from their business connection in British India is not ascertainable, he can assess their profits at a reasonable percentage of the turnover. Otherwise he can assess it at an amount which bears the same proportion to their total income as their Indian receipts bear to their total receipts.

In all these cases, the amount of the individual's income is not ascertainable, and a statutory substitute is provided by the Rules made under the Act.

REFUNDS, REVISION AND APPEAL

A necessary result of taxation at source is the provision for refunds. The deduction is made at the maximum rate, and individuals whose incomes are taxable only at a lower rate have to be refunded the excess tax thus collected.

[1] Till 1927 the proportion so taxable was 25 per cent.

[2] Rules 33 and 34, Income-Tax Manual.

There are no refunds under Super-Tax, because it is collected direct from the assessee.[1]

Claims to refund have to be accompanied by the claimant's return of income in the prescribed form. The rate of relief will be the difference between the maximum rate and the rate applicable to his income.[2] The assessee is given the option to receive his relief either in cash or set it off against the tax payable by him on his directly assessed income. No claims are entertained that relate to refunds beyond a year from the recovery of the tax.[3]

When the same income is taxed twice—once in Great Britain and once in India—the effective tax paid is the one with the higher rate. The lower tax is refunded to the assessee. So far as relief is concerned, the first charge is on the British Exchequer, to the extent of one-half of the British rate of tax. The remaining relief, if any, is given by the Indian Government subject to the maximum of one-half of the Indian rate.[4]

Appeals against the Income-Tax Officer's decision lie to the Assistant Commissioner.[5] The Assistant Commissioner has the power to enhance as well as reduce the assessment fixed by the Income-Tax Officer.[6] Appeals against the Assistant Commissioner's judgment lie to the Commissioner, but only in case he imposes a penalty or enhances the original assessment.[7] On a question of fact, there is no appeal.[8] On a question of law, however, the assessee can ask the Commissioner to state the case to the High Court.[9] The Commissioner can also make a reference to the High Court, either on his own accord or

[1] The only case of deduction of Super-Tax at source is from the dividends of companies accruing to non-residents.

[2] Section 48, Income-Tax Act, 1922.

[3] ,, 50, Ibid.

[4] ,, 49, ,,

[5] ,, 30, ,,

[6] ,, 31, ,,

[7] ,, 32, ,,

[8] ,, 67, ,,

[9] He has to pay a fee of Rs. 100.

at the request of an Income-Tax Officer. Where he declines to do so, and the assessee is not satisfied with his decision, the assessee can move the High Court to compel the Commissioner to state a case; and if the Court so orders, the Commissioner has to present the case before it. The Court can also ask him to supplement the reference on points that it thinks necessary for arriving at a proper judgment of the case. [1] The decision of the High Court is binding on the Commissioner as well as on the assessee. There is the usual provision for appeal to the Privy Council. [2]

The right of appeal, however, is not granted to every assessee. Only those who have conformed to the law, that is, have submitted returns of their income, presented accounts and otherwise observed the provisions of the Income-Tax Act, are given the right of appeal. Other assessees, who have not done so, cannot appeal against their assessments. [3] But if there is some reasonable excuse for the delay in presenting returns, the assessee is restored his privilege of appeal on submission of his return. [4]

In addition to revision through appeal, the Commissioner has the power to review any proceedings under the Act, and if necessary, alter the assessment. [5] But the assessee has a right to be heard before the assessment is enhanced.

PENALTIES

A penalty of Rs. 10 for every day during which the default continues is imposed in the case of the following offences [6]:—

(1) Failure to deduct tax.

[1] Section 66, Income-Tax Act, 1922.
[2] ,, 66-A, Ibid.
[3] ,, 30, ,,
[4] ,, 27, ,,
[5] ,, 33, ,,
[6] ,, 51, ,,

(2) Failure to furnish returns of income.
(3) Failure to produce accounts and documents demanded by the Income-Tax Officer.

If, in any return under the Act, the assessee makes a declaration that is false or which he knows or believes to be false, he has committed a penal offence,[1] the maximum punishment for which is simple imprisonment for six months or a fine of a thousand rupees or both.

Information gathered by any Income-Tax Officer, under any proceedings under the Act is treated as confidential; and disclosure of the same is punishable with imprisonment for six months and also a fine.[2]

SUMMARY

The Income-Tax of India is very simple. It taxes the net annual income, arising or received in British India, of all individuals, whose incomes are above Rs. 1,999 a year. Certain exemptions are made under the Act; otherwise, there is no complexity, differentiation and personal allowances being conspicuous by their absence. A part of the tax is collected at source, the rest by direct assessment. Where income is not ascertainable, the law provides a statutory equivalent. The executive are the sole appellate authorities on matters of fact, while there are ample provisions for appeal on matters of law. No non-official machinery is utilised by the State, either in assessment or in appeal.

In the succeeding chapters, we shall analyse the existing system in its various aspects, compare it with that of other countries, and finally suggest reforms, with a view to bring the Indian tax into line with correct theory, and the best modern practice.

[1] Section 52. Income-Tax Act, 1922.
[2] ,, 54. Ibid.

CHAPTER IV

THE SCOPE OF THE TAX—INCOMES CHARGED

In this chapter, we shall consider in detail the different incomes which are liable to the Indian tax, leaving for the succeeding chapter the question of those which are specifically exempt. Before doing so, however, it may not be out of place to consider what the term "income" means under the Indian Act and how far it corresponds to the economic concept of income.

From a strictly economic point of view, income means the net accretion to an individual's ability between two set periods of time. Thus, utilities accruing in non-monetary forms ought to be as much income as those which can be expressed in terms of money. Similarly, the additional ability resulting from capital appreciation should also be counted as income. Whether casual or non-periodical receipts ought to be treated as *income* is a debatable point, though from a strictly economic point of view, they should also be treated as income, since they undoubtedly increase the individual's ability. We shall therefore analyse the Indian system with special reference to its treatment of the following aspects :—

(1) 'Psychic' income.
(2) Capital gains.
(3) Casual profits.
(4) Gross income.

(1) *Psychic income*. The Indian position in relation to the taxation of 'psychic' income is fairly satisfactory, in so far as it tries to reach it as far as practicable. For example, Indian law subjects to income-tax rent-free quarters and residential house-property, neither of which

form money-receipts, though measurable in terms of money. This procedure does, in fact, show a considerable advance over the corresponding British and American income-tax provisions.[1]

(2) *Capital gains.* Capital gains are specially exempted from the Indian tax. For example, the profits which an individual receives from the increased value of his securities, shares, house property or other fixed capital are not liable to income-tax. Even the value of bonus shares, though unmistakably distributed out of profits, has been held to be an accretion to capital and therefore not taxable.[2] Legacies, though not specially exempt, are not charged in actual practice as they form additions to the individual's capital and not his income.

It may be pointed out at the outset that the exemption of legacies is a common feature of the income-tax systems of most foreign countries. Even the exemption of capital gains is, with the exception of the United States, widely prevalent abroad. But this similarity of foreign practice is not a legitimate justification for its adoption in India. In almost all the other countries, where legacies and capital gains are free from income-tax, they are reached by special tax-measures. Inheritance taxation—or Death duties as it is otherwise known—forms an essential part of the tax system of some countries. "It is found in every democratic community and it is everywhere becoming of increasing fiscal and social importance."[3] In India, on the other hand, such a system is conspicuous by its

[1] Vide chapter XI Spaulding's "The Income-Tax in Great Britain and United States". "The British treat as taxable income the annual value of a house occupied by its owner and exempt rent-free quarters. In the United States, the reverse is true in each case".

[2] Steel Bros. & Co. vs. Government. Commissioner of Income-Tax vs. Binny & Co.; cases 79 and 82 respectively I. T. C.

[3] P. 157—Seligman's "Studies in Public Finance". He continues "It seems needless to indulge in any theoretical argument in its defence; the statesmanship as well as the scholarship of the world has long since passed beyond that point".

absence. There are a few probate duties, but these are limited to particular communities, and further, the taxation they involve is very inequitable in its incidence.[1] The major communities thus pay neither income-tax nor inheritance-tax on that part of their "ability" which is represented by legacies and capital gains. Their exemption from the income-tax therefore, has not the same justification that it has in foreign countries. At the same time, this cannot justify an inclusion of capital under income; legacies, therefore, should continue to be exempt. As regards capital gains, taxing them might prove an unprofitable business as provision will concurrently have to be made for allowing capital losses. In fact, the experience of the United States in attempting to tax this source of income has not been very happy,[2] and Spaulding, who has made a careful study of the British and American income-taxes,[3] does not recommend its extension. We cannot, therefore, propose the inclusion of capital gains within the meaning of income. At the same time, it is reasonable to point out that both legacies and capital accretions are additions to ability, and that the doctrine of ability to pay is violated by the absence of inheritance taxation in this country.[4]

[1] Europeans, Eurasians, Armenians, Jews and other foreigners are compelled to apply for probate to the courts. Letters of administration are also compulsory in the case of Parsis and Indian Christians. Hindus, Mahommedans and Budhists are exempt except in Lower Bengal where Hindus have to pay probate duties on testate succession. The rates are also very low—Vide Chapter XII of the Taxation Enquiry Committee's Report for a fuller discussion.

[2] Vide—Mr. Mellon, Secretary of the Treasury, (United States) with reference to capital gains. "The theory may be correct, but when we come to practice we find that, in order not to put all business and dealing in property in a straight-jacket, page after page of exemptions must be written into the law. With so many doors to the house, the effort to close them all has given us the most intricate tax law in history". Quoted on p. 136, Spaulding, Ibid.

[3] Chapter XI—Spaulding. Ibid.

[4] The only way to make legacies and similar accretions to ability pay their due share of taxation is to subject them to a graduated inheritance tax. Inheritance taxation however is essentially taxation of capital, and is consequently outside the scope of our subject.

The same considerations, however, do not apply to bonus shares. They certainly have a money value and increase the individual's ability. Any further exemption of these, means creating a fruitful method for corporate income to evade the personal super-tax.[1] It is desirable, therefore, to amend the law and include bonus shares under "income".[2]

(3) *Casual Profits.* All receipts which do not arise from the individual's profession or business and are also of a casual and non-recurring nature are exempted from the Indian Tax. This practice is evidently based on the conception of income as an *annual* event, only receipts possessing periodicity being regarded as taxable. While in accordance with the British practice, this exemption of casual receipts does not obtain in the United States which taxes all such income.[3] It should also be remembered that there is nothing sancrosanct in the "annual" concept, and that after all its raison d'être is not so much strict observance of theory as administrative convenience and popular practice. It is also obvious that casual gains do increase the recepient's ability. It appears then that these receipts should be made liable to the income-tax. We shall, however, refrain from making that recommendation, first, because the Indian Law does not exempt all casual income, but only that which is unconnected with the tax-payer's regular business,[4] and second, because taxing casual gains would involve allow-

[1] In Steel Brothers vs. Government already referred to, the amount thus distributed by way of bonus shares amounted to more than 56 lakhs.

[2] The Australian Commonwealth Income-Tax specifically includes as income "Bonus shares which capitalise certain profits". Income-Taxes in the British Dominions, H. M. S. O.—p. 236.

[3] Chapter IX Spaulding, Ibid.

[4] Commissioner of Income-Tax vs. Sir Purshottamdas Thakurdas, case 24, I. T. M. Vol. II; and in Re: Chunilal Kalyandas—case 103, I. T. C.

ing casual losses, thereby causing a net loss to the State.[1] Besides, casual gains do not easily lend themselves to graduated taxation, as being irregular, they do not measure the individual's real ability. The income-concept therefore need not be so enlarged as to include casual receipts.

(4) *Gross Income.* The question as to whether the Indian tax charges gross income or makes suitable allowances for expense incurred in securing the same is dealt with in full detail in a succeeding chapter. It may be sufficient to point out here that the Act taxes net and not gross income.

We can now attempt a definition of 'income' as understood by the Indian law. It includes all annual profits or gains derived from an employment of capital or labour or a combination of both, provided they are in the form of money or are reasonably capable of being converted into money.[2] No extension of this connotation is recommended except the inclusion of bonus shares as taxable income.

TAXABLE INCOMES

In the preceding section, we had attempted to analyse the meaning of 'income' in the light of the Indian Law; we shall now examine the different incomes which are taxable under the Indian Act with special reference to the territoriality of income and the residence of the owner.

The Indian Income-tax is levied on all income arising, accruing or received in British India. It is also levied on

[1] Such exemption might also stimulate fraud. The same remarks apply to profits from speculative transactions. At present they are not taxed unless they constitute the assessee's regular business.

[2] Cf. "Without giving an exhaustive definition, it may be described as the annual or periodical yield in money or reducible to money value arising from the use of real or personal property or from labour or services rendered bearing in mind that in some cases e. g. income derived from house property, the yield must be taken as the *bona-fide* annual value and not necessarily as the actual yield". Per Dawson Miller C. J. in Re: Jyot Prasad Singh Deo case 23—I. T. C.

incomes which are, under the provisions of the Act, deemed to arise, accrue or be received in this country. These taxable incomes can be classified under the following three groups.

(1) Income arising or accruing in British India.
(2) Income received in British India.
(3) Income deemed to have arisen, accrued or received in British India.

Incomes arising in India. So far as incomes under the first class are concerned, their ability is obviously based on the theory of origin, that is, on the fact that such incomes originate in the taxing country and are therefore proper subjects for taxation. This simple explanation however is not the one accepted officially. The Government of India have ruled that the words "accrue or arise" are contradistinct from the phrase "receive" and hence indicate a "right to receive". The 'source' element is thus thrown in the background and all incomes receivable in British India are made liable to the Income-Tax. [1]

Logically considered, this official theory leads to two results that are in direct contrast with the 'origin' basis; first, income, though arising in India, should be exempt from Indian Income-Tax if it is receivable abroad; second, income, though arising abroad, should be liable to the Indian Tax if it is receivable in India.

The Government of India were not sorry to accept the first inference. Incomes from the sterling securities of the Government of India and the sterling debentures of companies working in India—both of which were receivable in England—were not charged with the Indian Tax. [2]

[1] "Accrue or arise" as used in this connection are general words, descriptive of a right to receive and in this view the relevant portion of S. 4 (1) of the Act may be paraphrased. I. T. M., p. 84.

[2] In 1916 in answer to a question in the Imperial Council, Government asserted that sterling securities have been ruled by the law-officers of the crown to be technically not Indian securities—F. S. 1916—p. 138. cf. "It is an interesting and convenient legal friction to call the sterling securities of India, on which the Indian Tax-Payer pays the interests as

If the Government's receivability theory was correct, the pay, pensions, furlough and leave allowances arising in India, but receivable abroad (mainly England), ought to have been automatically free from the tax. But strangely enough, these incomes had to be specifically exempted by the Governor-General-in-Council.[1] Evidently Government was not certain of the correctness of their own interpretation, though they carefully enforced it in practice.

When the Government tried to carry out the second inference mentioned above, and to tax all incomes arising abroad if only receivable in India, the courts interfered and ruled that such foreign income was not liable unless *actually* received in India.[2] The court contemptuously dismissed "The right to receive" theory of taxation, one of the judges remarking "It is not the right to demand the profits which it is proposed to tax, but the profits themselves".[3] Government quietly accepted the verdict and refrained from taxing these incomes. At the same time they continued to exempt 'Indian' incomes receivable abroad, though the very raison d'être of that step viz. the receivability theory had been upset by the courts.

It is therefore clear that the outlandish 'right to receive' theory, which the Government ingeniously superimposed on the words "accrue or arise", does not really govern the entire scheme of the Indian Income-Tax. Its only prac-

being 'Not securities' of the Government of India". Vakil, Financial Developments in Modern India, p. 389.

By 1922 Government shifted its line of argument and started the "Right to receive" theory to defend the continued exemption of these securities from the Indian Tax. See I. T. M., p. 84.

During the course of cross examination of several witnesses, Sir Percy Thompson—a member of the Taxation Enquiry Committee—implied that these securities were issued in London 'Free of Tax'. It is obvious that this cannot be true, otherwise Government need not have resorted to the explanation given above.

[1] Under power given to him by S. 60 Income-Tax Act, 1922.

[2] Commission of Income-Tax v/s Ramanathan Chetty, in re: Aurangabad Mills, Board of Revenue v/s Ripon Press and Sugar Mills—cases 14, 26 and 52 respectively. I. T. C.

[3] Per. Oldfield J.—in Board of Revenue v/s Ramanathan Chetty. Ibid.

tical effect is to remove from the scope of the Indian tax large amounts of income undoubtedly originating in India. In the previous chapter we have referred to the enormous loss of revenue hitherto caused by such exemption. The revenue we are losing from the same source is much greater to-day on account of the great rise in the rates of Income-Tax during the last ten years. Moreover, we are losing revenue for a concept which has no basis in theory. The phrase "accrue or arise" unmistakably denotes origin, whereas receivability is only a mild variant of 'residence', the presumption being that "the right to receive" rests in the same place as the residence of the owner of income. Thus, while the law attaches greater importance to the *place* of income, the Government pays more attention to the place of the owner of income, thereby trying to superimpose 'Residence' on 'Origin'. But Residence and Origin are rival principles. How can we then interpret origin in such a way as to mean residence? And yet, that is what the Government has attempted to do in framing this receivability theory. We are, therefore, reluctantly led to the conclusion that Government did not seriously accept the theory of receivability, but only invoked its aid to exempt certain Indian incomes that are received in England.[1] Such a practice is clearly opposed to the intention of the Indian law and cannot be sufficiently condemned.[2]

[1] If the Government is to be taken seriously in their theory, it means that the scope of the Indian tax was in practice governed simultaneously by 'Origin' and 'Receivability'—both so combined as to exempt as much income as possible. This position is still less defensible on the part of the Government than that of being not serious about the 'Right to receive' theory.

[2] Our position is considerably strengthened, when we remember that in Canada and South Africa incomes from salaries, pensions and allowances, though receivable abroad, are subject to the tax. Interest on their Government securities which are foreign owned are specifically exempted; but this only shows that without a specific exemption—and there is no such exemption in the Indian Law—such income is clearly taxable—I. T. B. I. pp. 57, 59, 10.

Incomes received in India. Under this head are taxed incomes which though not originating in India are yet received here. Such liability is presumably based upon the fact that income received in this country is enjoyed in this country, and is therefore a proper subject for taxation. This explanation gains additional strength when we remember that income originating abroad though accruing to Indians is not taxable unless received here.

The intention of the law, however, is not carried out in actual practice. Certain qualifying provisions along with some judicial decisions have succeeded in almost nullifying the effect of this primary "charging" clause. For example, income received from abroad from any source other than business is exempt, if not received during the actual year of its accrual. Similar income from business is exempt, if not received within three years after its accrual.[1] This means that by postponing the receipt of his non-Indian income from business for three years, and from other sources for one year, an individual can safely avoid payment of the tax, though this income might be subsequently received and enjoyed in this country.

While the law itself has thus made possible the escape from taxation of a good proportion of the income received in India, judicial decisions have accelerated the process by removing from the scope of the tax large amounts of similar income.[2] The courts have found the justification for such exemption in the theory that the same amount cannot be twice received as income.[3] In one case, the assessee's income amounting to nearly Rs. 24 lakhs, accrued and technically received abroad, but later brought

[1] S. 4. (2), Income-Tax Act of 1922.

[2] Vide.—Sunder Das v/s Collector of Gujarat, Board of Revenue v/s Ripon Press and Sugar Mills, Sir Ali Imam v/s. The Crown—cases 47, 26 and 96 respectively, I. T. C.

[3] Per Coutts-Trotter J. in Board of Revenue v/s. Ripon Press and Sugar Mills. Ibid.

into the Punjab, was held exempt.[1] In another case, the income was first credited to the assessee's banking account in a foreign territory and was transmitted to British India a fortnight later. The courts held that this amount was not received in British India and hence not taxable.[2]

In this way for all practical purposes, incomes arising abroad but received in India are not subjected to income-tax. Such incomes can be literally enjoyed in this country, and yet escape taxation despite the clear intention to the contrary contained in the primary charging clause.

Incomes deemed to arise in India:—The third class of incomes taxable under the Act are incomes which are deemed to arise, accrue or be received in this country. Apparently a legal fiction is thus created, by which certain non-Indian incomes are made equivalent to Indian Incomes for the purposes of the Indian Income-Tax Act. Such incomes are[3]:—

(1) Salaries of persons resident in India, though not British India, which are paid either by the Indian Government or by any duly constituted local authority. In the latter case, the incomes are taxable, only if they accrue to British subjects.

(2) Income of non-residents arising from any property or business connection in British India.

(3) Profits and gains derived by non-residents from the sale of merchandise in British India.

[1] Sunder Das v/s. Collector of Gujarat. Ibid.

[2] The assessee, Sir Ali Imam, received an honorarium from the Nizam's Government of about Rs. 2 lakhs. The formal receipt for the same was signed at Patna; but the money was first paid in the Hyderabad branch of the Imperial Bank of India. The Court held that the receipt signed in British India, though evidence of the fact that the money had been received, was not conclusive proof of its receipt in British India and therefore declared the income to be exempt.

[3] "This Act shall apply to all income, profit or gains, as described or comprised in S 6, from whatsoever source derived, accruing, arising or *received* in British India..." S. 4 (1). Income-Tax Act, 1922. The italics are ours.

(4) Profits derived by foreign non-residents in India.

(5) Professional fees paid in any part of India to persons ordinarily resident in British India.

(6) Business incomes arising abroad but received in this country are deemed liable, notwithstanding the fact that they might not have accrued during the year of receipt. The liability does not arise if these incomes are brought into India three years after their accrual.

If non-Indian incomes are deemed to be Indian incomes for purposes of the Act, they can only be so in so far as they are owned by residents. Despite any legal fiction, the Indian Legislature has no power to levy an Income-Tax on the non-Indian incomes of non-residents. Such an effort would involve international conflict.[1]

This head is therefore intelligible only if the different items it enumerates are of the nature of foreign income owned by Indian residents and not received in India. Examining them one by one, however, we find that all of them relate to income that either directly or indirectly originates or is received in this country, i.e. income which would be legitimately taxable without the special aid of this clause. Thus, salaries paid by the Indian Government to residents of Native States are evidently derived from British India. Similarly it can be argued that incomes derived by non-residents from (1) property, (2) business connections, (3) sales of merchandise and (4) transactions in British India are all of Indian origin. Professional fees paid outside British India are generally brought into and consequently received in British India. Similarly incomes from business abroad, even if received

[1] "The power of taxation of any state is, of necessity, limited to persons, property or business within its territorial Jurisdiction". Wharton's Conflict of Laws Vol. I. Also cf. Bar's "International Law". "To collect income-tax in a foreign country would very frequently encounter insurmountable difficulties". Quoted by Sheshagiri Ayyar J. in Commissioner of Income-Tax vs. Ramanathan Chetty, I. T. C. p. 44.

after one year, are still ultimately received and enjoyed in this country.

The incomes which are deemed to arise or accrue in India are incomes which do not need any such legal fiction to make them liable to the Indian tax, as they are for the most part equally well taxable under the original 'charging' section. These subsequent clauses therefore do not really create any legal fiction nor do they widen the scope of the tax. We see no necessity for their continuance; instead of widening the scope, they only create an illusion of extension of liability. [1]

Summary. Summing up our analysis under the preceding three heads, we find that while incomes originating in India are generally taxable, some of them are exempt. Incomes received in India are declared taxable, but generally manage to escape their liability. Incomes arising and received abroad but owned by Indians are not liable, despite appearances to the contrary. Thus, from the point of view of territoriality of income, the scope of the tax is determined by the origin of the income, but so modified by the 'receivability' theory as to result in the exemption of large amounts of such income accruing abroad.

The same conclusions can be repeated in another form, if we analyse them from the point of view of the liabilities of residents and non-residents.

Residents :—Residents of British India are chargeable on their Indian income plus that part of their foreign income, which is received in British India. The latter clause is hedged in with such provisos, and the meaning attached to 'Receipt' is so loose, that for all practical purposes, the Indian resident pays tax only on his Indian income.

Non-residents :—Non-residents are liable to tax on

[1] The only material end these clauses serve is to clarify and set forth in detail incomes originating in India but accruing to non-residents. The proper place for this however is not in the text of the Act but in the rules made under it.

their Indian income. In actual practice they are not taxed on that portion of their Indian income which is receivable abroad, namely, interest on sterling securities and sterling debentures, annuities, salaries, pensions, furloughs and leave allowances.

PRINCIPLES GOVERNING THE SCOPE OF INCOME-TAX

Before proceeding to enunciate and criticise the principles which govern the scope of the Indian Income-Tax to-day, we may point out that, theoretically considered, there are only two principles which either singly or in combination govern the scope of all direct taxation. The principle of 'origin' enjoins the tax to be levied upon all income arising in the taxing country, without regard to the residence of the owner; the principle of 'Residence' imposes liability on the total income of the residents in the taxing country, without regard to the place of origin of their income.

Theory offers no guidance in the choice of either of these principles as they are both based upon the instinctive human feeling of what is right. Thus, it seems just that the income which is created under the protection of and on the surface of any one country should repay it in the shape of tax contributions; it also seems just that the individual who lives in a country and enjoys the protection of its laws should repay it in the shape of tax contributions. The resident's income as well as the income arising in the country owe economic allegiance to the government of that country. Both 'origin' and 'residence' are then just and equitable principles. What should be the governing principle in the case of any one particular country will depend upon its peculiar needs and circumstances. There is no prima facie theoretical solution.[1]

[1] Two attempts however have been made to provide a theoretical solution. Sir J. C. Stamp proposes a flat tax based on 'origin' combined

'oreign practice is as helpless as theory in suggesting ›lution. The practice of each country is determined by ›wn conditions. If a nation is largely a debtor country, iving little foreign income but sending much of its own ›me abroad, then the interests of that country will be t served by basing its income on "origin" ; the element ·esidence can safely be ignored as its neglect will not ›lve much loss of revenue. Typical instances of such ntries are probably the young nations, viz.:—the ninions, South Africa, Canada and Australia. If on other hand a nation is largely a creditor country, :ving a large foreign income, but sending very little of own income abroad, then the interest of that country be best served by basing its income-tax on "resi- ce". We can adduce no instance of a country so dominantly a creditor. Finally, if a country is both a tor and a creditor, the best interests of that country be served by adopting both, the principles of 'origin' 'residence'. The classical instance of such a country of course, Great Britain. We can, therefore, draw no matic conclusion from the experience of foreign ntries.

Neither theory nor practice can, therefore, furnish us 1 the exact principle for determining the scope of ›me-tax. The only general principle which can be ly formulated is that the scope of the income-tax of ry country shall be such as will promote its best inter- , and secure maximum revenue. The proper scope can y be found with reference to the needs and circum- ices of every country.

with a graduated tax based on 'residence'; this will only lead to lower taxation of non-residents and handicap residents in their competition with the former.

The League of Nations appointed a Committee of experts who have attempted to classify various kinds of income according as they are predominantly due to origin or domicile. We do not accept their classification for reasons given in our subsequent chapter on "The Problem of Double Taxation".

PRINCIPLES WHICH SHOULD GOVERN THE SCOPE OF THE INDIAN TAX

Coming to the Indian problem, the Indian Income-Tax to-day is governed by the principle of 'origin' as considerably modified by the 'right to receive' theory. Residence plays no part in determining liability. The net result of this is that Indian residents pay the tax on their Indian income, while non-residents pay it on some portion of their Indian income. The question for us now to consider is whether this position needs revision and if so, in what directions.

The first point to be noted is that India needs the largest amount of revenue she can possibly raise from this source consistently with considerations of equity. The scope of the income-tax ought, therefore, to be of the most comprehensive kind; and any case of non-taxation of income ought to have the strongest justification before it can be allowed. It should further be remembered that India is largely a debtor country with huge payments to make abroad;[1] and if foreign practice can possibly yield any lesson, it is towards the wholesale and unmodified acceptance of the 'origin' basis.[2] At the same time no case has been made for the exemption of incomes receivable abroad from the Indian point of view. It involves an annual loss of about Rs. 108 lakhs[3] which we can ill afford and thus adds to the annual drain of wealth from this country. It follows, therefore, that the present exemption from income-tax of Indian incomes receivable abroad is

[1] e. g. Home charges, Insurance, freight charges, banking charges, profits of foreign commercial and industrial entrepreneurs and other similar payments which swell our exports.

[2] Cf. Manchester Guardian Special Number "Reconstruction in Europe" Section V, pp. 305-06.

[3] The total amount of interest on Debt (Railway and other than Railway) amounted in 1926-27 to about £ 16 million. The maximum Indian rate of only 'income-tax' is 18 pies in the rupee or about 9 per cent. If we assume that these incomes will pay at 5 per cent., the total revenue realisable will be £8 lakhs or Rs. 108 lakhs.

opposed to the best interests of India and should forthwith be discontinued.

Our recommendation will result in the taxation of two distinct kinds of incomes viz. pensions, furlough allowances, etc. payable abroad, and interest on sterling securities. No possible objection can be raised against the first item, especially when it is realised that Dominions as well as some other countries follow the same practice.[1]

As regards the taxation of sterling securities it may be contended that such a step will only recoil on the heads of the Indian taxpayers in the shape of either an increased rate of interest or a discouragement and ultimate cessation of the import of foreign capital. With reference to the first objection, it should be remembered that the interest on the large stock of the existing sterling securities cannot be increased by the tax. The effect, if any, will operate only with reference to new issues; but the loss thus accruing will not be appreciable, first, because the declared loan policy of the Government of India is the encouragement of rupee and not sterling issues; and second, because, with centralised banking institutions and increasing banking facilities, the Indian people will largely be able to supply their own loan requirements. As regards

[1] The Taxation Enquiry Committee's calm acceptance of the exemption as justified on the grounds of domicile, is hardly to the point, as the Indian law taxes all incomes arising or accruing in the country, and says nothing about residence. Taxation Enquiry Committee's Report Vol. I, p. 192.

The practice observed in the Dominions is conclusively against their recommendations. cf. South Africa which taxes "Any pension or annuity granted by any person residing or carrying on business in the Union or by the Union Government or Railway or Harbour administration or Provincial or Local authorities, *wherever payment is made,* unless the services for which such a payment is made were performed wholly outside the Union". Income-Taxes in the British Dominions, p. 57.

Also cf. Prussia and Austria "Irrespective of nationality domicile or residence, all persons are liable to income-tax who derive income from salaries, pensions and half-pay paid out of the Prussian Exchequer". Foreigners not residing in Austria are liable in respect of income from pay or pensions from the Austrian Exchequer. Graduated Income-Taxes in Foreign States, pp. 39 and 101.

the bogey of discouragement of foreign capital, the question has nothing to do with the taxation of sterling securities. Foreign capital, so far as it is employed in Indian commerce or industry, is already subjected to the tax, and the burden on it is in no way increased by the taxation of sterling securities. On the other hand, it will only remove the special privilege enjoyed by foreign capital in one type of Indian investment and restore things to an equal level. The problem of discouragement of foreign capital is bound to crop up under any income-tax whose scope is extensive, and we will consider it in detail in the chapter on Double Taxation.

We may therefore conclude that taxation of Indian income payable abroad will not injure Indian interests in the least but only remove a long standing anomaly yielding at the same time a much needed addition to the Indian Exchequer.[1] While this will enforce the 'origin' basis in all its completeness, it leaves alone the principle of 'residence' which, as we have seen, plays no part in determining the scope of our tax. At the same time, enforcement of the 'residence' basis will undoubtedly yield an appreciable amount of revenue. For example, the enterprising mercantile community of Gujarat have incomes arising in different parts of the world—more particularly in East Africa and the neighbouring Protectorates. Further, the Natukottai Chettys of the South have an extensive trade and money-lending practice spread through Indo-China, Hongkong, Shanghai, the Federated Malay States and other Eastern countries.[2]

[1] The Taxation Enquiry Committee has not given any lead on the question of sterling securities. Apparently they desire the continuance of the status quo. Their only recommendation is that if sterling loans are issued in the future, the prospectus should lay down the existence or otherwise of their liability to the tax. Taxation Enquiry Committee's Report, Vol. I, pp. 192-193.

[2] Vide.—The statement of case by the Commissioner of Income-Tax in Board of Revenue v/s Ramanathan Chetty, case 14 I. T. C.

A further not undesirable consequence would be the concentration of Indian capital investment in India alone.

The financial argument is not the only one in favour of the adoption of the 'residence basis'. Even on grounds of equity, there is no reason why those persons who reside in this country and therefore owe it economic allegiance should not be taxed on their total income. It should be further remembered that even as it stands to-day, the law seeks, though unsuccessfully, to tax foreign income if received in this country. One way of thoroughly enforcing the provisions is to extend the scope of the tax so as to include the total income of Indian residents, irrespective of its origin or place of receipt. In that case, it will not pay the resident to keep his income abroad or technically to avoid receipt in India. The basis of 'residence' should therefore be also applied in fixing the scope of the tax.

SUMMARY

To conclude our survey, the scope of the Indian Income-Tax is unsatisfactory as it exists to-day. It unduly exempts large amounts of income and also results in extensive evasion. The present scope of the tax should therefore be so extended as to include :—

(1) All income arising in the country wherever and by whomsoever it may be received.

(2) The total income from all sources, wherever derived or received, of its residents.[1]

Thus the queer theory of 'receivability' as determining liability to taxation will be finally discarded, and 'origin' and 'residence' will become the twin bases by which the scope of the tax will be governed.

[1] The definition of a resident might be made on the British lines so as to include not only persons staying for more than six months in the country, but also those who, though temporarily abroad, have their permanent homes in India.

CHAPTER V

The Scope of the Tax—Exemption of Agricultural Incomes

In the words of the Simon Commission, "the most striking feature of the Indian income-tax is the exemption granted to agricultural incomes by the Act of 1886, which has continued ever since."[1] This exemption, of which we have already given a few details in our historical survey, is ostensibly based on a desire to avoid double taxation.[2] It is thus not based on any social or philanthropic principles, such as those which underlie the exemption of contributions to charities, insurance premia etc., but rests on canons of taxation, and can therefore be judged from the principle of ability to pay. It will be convenient to discuss the subject matter of this chapter under the following main heads :—

(1) Scope and extent of the exemption.
(2) The Actual Beneficiaries.
(3) Defects and remedies.
(4) Estimated yield.
(5) Administrative considerations.

SCOPE AND EXTENT OF THE EXEMPTION

Agricultural income is specifically exempted from the scope of the Indian Income-Tax Act. It is statutorily defined and includes the following items[3] :—

[1] Report of the Indian Statutory Commission, Vol. I, p. 359.

[2] Vide Sir Auckland Colvin's speech in introducing the Income-Tax Bill of 1886. Also cf. Taxation Enquiry Committee's Report, p. 212.

[3] Section 2 (1) and 4 (3) (viii) Income-Tax Act, 1922.

1. Rent or Revenue derived from land used for agricultural purposes.
2. Profits from agriculture.
3. Income derived by the cultivator from processes ordinarily employed by agriculturists to make their produce marketable.
4. Income from the sale of such produce.
5. Income from house-property that is in the vicinity of the land and is needed for purposes of the agricultural profession.

An essential preliminary for the exemption of agricul-ral incomes is the previous taxation of land; in other ords, only that agricultural income is exempted which is ·eady assessed to either a local rate or land revenue. ouble taxation, then, is the plea on which the exemption agricultural income from the income-tax is justified.

In spite of such a detailed definition, many difficulties e found in the actual administration of the exemption, me of them arising from the thin line of demarcation tween agricultural and non-agricultural income. Apart om the question as to what the term "agriculture" actly connotes, difficulty is especially felt with regard the application of the exemption to incomes derived om processes ordinarily employed by cultivators to make eir commodity marketable. An element of manufacture obviously visible in the process, and the line of distinc-n between ordinary and extraordinary methods is very in.[1] As a matter of fact, the uncertainty has been so eat that ever since the inception of the income-tax, gar factories and tea companies were entirely exempt til the courts ruled that they were liable to pay income-x on the non-agricultural portion of their income;[2] and

[1] Cf. "Like all questions of degree, this question is beset with baffling borderland cases. Thus the husking of paddy is an agricultural operation; so is the preparation of brown sugar, but not sugar refining or milling of paddy." Sunderam's Law of Income-Tax in India, p. 163.

[2] In Re: The Bikanpur Sugar Concern, Killing Valley Tea Co. v/s Secretary of State for India, cases 13 and 17, I. T. C.

it is only recently that the Board of Inland Revenue has framed special rules for the proper taxation of such mixed incomes.[1] The concept of modern income and its origin is so complex that the exemption of such an important source naturally gives rise to some confusion. At the same time it must be pointed out that agricultural income, does not and should not mean, as has sometimes been assumed, anything and everything connected with land. Income from fisheries, markets, moorings, fences, stone-quarries and mines are clearly non-agricultural and ought to be liable to the tax. But recent judicial decisions have resulted in the exemption of even such non-agricultural incomes,[2] (with the exception of the income from mines) if they are derived from permanently settled estates.[3] In practice, therefore, the exemption has begun to extend even to incomes which are clearly non-agricultural; while the difficulty of defining agricultural income confuses, and makes uncertain, the real liability of the taxpayers.

THE ACTUAL BENEFICIARIES

The following table[4] sets forth at a glance agricultural holdings whose owners enjoy exemption from income-tax :—

[1] Rules 23 and 24, Income-Tax Manual.

[2] Shivlal Gangaram v/s Commissioner of Income-Tax; Emperor v/s Raja P. C. Barwa, quoted in Sunderam ibid. p. 151.

[3] Commissioner of Income-Tax v/s Zemindar of Singampatti; Dharbhanga v/s Commissioner of Income-Tax, cases 44 and 98, I.T.C. A contrary decision was given by Rankin J. in Emperor v/s Probat Chandra Barwa, case 73, I. T. C.

[4] The figures in this table are compiled from the Land Revenue Administration Reports of the different provinces as under :—

Bombay, 1926-27; C. P., 1921-22; Punjab, 1922-23; Burma, 1926-27; Assam, 1927-28; Bihar and Orissa, 1923-24; Bengal, 1927-28; Madras, 1921-22.

Corresponding figures for the U. P. are not available.

Province	Permanently settled Estates		Temporarily settled Estates	
	Holdings in thousands	Land revenue assessed in lakhs of Rs.	Holdings in thousands	Land revenue assessed in lakhs of Rs.
Bengal	94	216	4	22
Bihar and Orissa .	104	107	13	27
Madras		50	3859	503
Bombay . . .			2328	462
Central Provinces .			2018	119
Punjab			3429	438
Burma				340
Assam			1190	80

The statistics of holdings in the case of zemindari estates which include all the permanently settled estates of Bengal, Bihar and Orissa and Madras, the Malguzars of C. P. and a good proportion of the total holdings in the United Provinces, indicate only the landlords. The cultivators are also exempt. In the case of both the ryotwari and the zemindari estates, the tenure-holders and the co-sharers also get the benefit of exemption.

Analysing the figures, we find that the number of persons exempted (assuming that every holding or estate represents at least one person) is much larger in the case of ryotwari[1] areas. This might, at first sight, lead to the inference that the ryotwari holders of land are more benefited by the exemption than zemindars. But if we take into account the fact that the Indian Income-Tax, as it exists to-day, exempts persons with annual incomes of less than Rs. 2,000, and also remember that the annual income of most of these ryots is less than Rs. 2,000,[2]

[1] The figures of Bombay refer to the number of persons and not holdings.

[2] Cf. A. W. Mackie, Director of Land Revenue Records, Bombay, "With a high limit like Rs. 2,000......there would be few cases to deal with. The number of assessees will be very small", pp. 387 and 398 Vol. vi T. E. Committee Minutes of Evidence, also Mr. S. A. Smyth (North-

we come to the conclusion that the exemption under section 4 does not materially benefit these persons ; for, even if agricultural incomes were made liable, most of these persons will continue to be exempt, as their income is below the taxable minimum. It is only the very small number of those ryotwari holders whose annual income is above Rs. 2,000 that are really benefited by this exemption.

Zemindari estates, on the other hand, are held largely by rich persons who, but for this exemption, would be chargeable with income-tax. [1]

We can therefore conclude that the exemption of agricultural income is chiefly advantageous to landlords. Any removal of it will practically leave unaffected the ryotwari cultivators but will certainly result in the levy of income-tax on zemindars.

DEFECTS AND REMEDIES

Income from Temporary settled Lands :—We shall first consider the case of agricultural income derived from temporarily settled estates. [2]

West Border division). "The average proportion of cultivators who make a profit of Rs. 2,000 a year on cultivation is small probably not more than 10 per cent. in Upper Burma". T. E. Committee, Vol. VI, pp. 16-17. Also Mr. Gimson, Commissioner of Income-Tax, Assam. "The number of working persons whose income exceeds Rs. 2,000 a year cannot be as much as 1 per cent. of the whole", Vol. V, T. E. p. 383, also Sir P. Thompson a member of the T. E. Committee asserted, that out of 3½ million cultivators in the Punjab, only 2300 pay even as much as Rs. 500 by way of Land Revenue", Vol. IV, T. E. p. 376. The fact that most of the ryots have a very small income is still more clearly revealed by Sir Charles Todhunter (President, T. E. Committee) who asserted that more than three quarters of the people at present paying land revenue pay less than Rs. 50 each, Vol. III, T. E. p. 188.

[1] Thus, for instance, in Madras, out of 241 lakhs of zemindari income, about 110 lakhs were held by about 13 persons. Madras Land Revenue Report, 1913-14.

[2] The chief feature of the temporary settlement system is that once in every 30 years (or a similar specified period) the income from land is re-valued and land revenue is re-assessed, generally resulting in a large increase on the original assessment. This keeps the state demand at par with the increasing annual value from land. This system is largely to be found in Bombay, Madras, United Provinces, Central Provinces, Punjab and Burma.

The Taxation Enquiry Committee, after an elaborate historical examination, arrived at the conclusion that the chief reason for exempting agricultural incomes from income-tax lay in the levy of cesses on land, and with the abolition of these cesses in 1904, agricultural income lost its legitimate grounds for exemption.[1] They have thus completely ignored the factor of land revenue in influencing the exemption. It is of course true that in 1886, Sir Auckland Colvin described the existence of concurrent cesses on land as the sole cause for exempting agricultural incomes. But if the payment of cesses was the only factor, then, on their abolition in 1904, Government would have annuled the exemption. The fact that they did not do so is conclusive evidence to show that the real reason they had in mind in exempting agricultural income was its payment of land revenue. This conclusion is strengthened by the fact that in 1922, Government so amended the definition of "Agricultural Income" as to make payment of British Indian Land Revenue (or local rate) an essential condition for obtaining the exemption. Now land revenue is essentially a tax on "Agricultural Income".[2] In the calculation of net assets, the value of the cultivator's labour service is not necessarily included. Similarly, no mention is anywhere made of any deduction for interest on his capital. The result is that the payment made as land revenue goes beyond rent, and enters into the personal subsistence and profits of the individual. There can be no doubt, therefore, that when a person pays land revenue, he pays to the State something in the nature of a tax on his income from land.[3]

[1] Vide p. 203 et. seq. T. E. Committee's Report.

[2] Cf. Vakil "The principle that land revenue is a tax on agricultural incomes and not a rent ought to be accepted in practice", Financial Developments in Modern India, p. 349. Mr. Baden Powell, after a thorough study of the whole problem has arrived at a similar conclusion. See Taxation Enquiry Committee Report, Vol. II.

[3] The ancient "Rent" theory received, for all practical purposes, its final death blow when the Taxation Enquiry Committee included land

Taking these two facts into consideration together, viz., that incomes from land pay land revenue and that agricultural land revenue is of the nature of a tax, the conclusion is irresistible that agricultural incomes are exempted from the income-tax in order that they may not be subjected to double taxation.

Prima facie, such an exemption is of course entirely justifiable; but, considering the fact that non-agricultural incomes pay income-tax, the exemption of agricultural incomes cannot be justified even on grounds of double taxation, unless the incidence and effects of the land tax, for paying which they are exempt, are similar to those caused by the income-tax. In other words, the principle of ability to pay must be the guiding factor in determining both land revenue and income-tax.

Applying this test to the land revenue as at present assessed on temporarily settled lands, we find the following divergences from "*ability to pay*".

First, a large number of persons, holders of hopelessly uneconomic holdings, has to pay to the state a considerable amount in relation to their income, whereas under the income-tax, they would be totally exempted.

Second, owing to the fallacious theory of land revenue being regarded as rent, persons with smaller incomes as well as bigger incomes pay at the same rate; whereas, under the income-tax, these payments will be based on 'ability' and will be levied on a progressive scale.

Third, cultivators with large agricultural incomes are immensely benefited and pay tax at a rate that is lower than the corresponding rate on non-agricultural incomes.[1]

It is clear that the benefits accruing from this exemption are not distributed in accordance with "ability".

revenue as an important item in their discussion of the incidence of Indian Taxation.

[1] In Madras, the percentage of assessment to rental averaged to about 17 per cent. The highest rate of income-tax and super-tax payable is about 30 per cent., T. E. Committee's Report, p. 77.

Land Revenue taxes persons whom the income-tax would exempt, and it takes less from persons from whom the income-tax would take more. If our conclusion that agricultural income is exempted from income-tax for fear of double taxation is correct, then it is clear that the exemption cannot be justified, unless the land tax brings about results in accordance with those of the income-tax. Far from doing that, land revenue brings about results directly in contrast with those of the income-tax. Therefore, there can be no doubt that this exemption is not justifiable on the ground of "ability", on which alone a direct tax can be framed. The only logical conclusion is the abolition of the land revenue, followed by the amalgamation of agricultural incomes into the ordinary income-tax.

This course, however, would entail a great reduction in revenue which the Provincial Governments are not prepared to face. Even if accompanied by a provincialisation of income-tax, Provinces like Madras, Punjab and Burma, which are largely agricultural and do not possess many rich landlords, will be faced with big deficits. If land revenue is an irreplaceable factor of provincial finance,[1] then, of course, we cannot press for the exemption of those taxed agriculturists who would be free under the income-tax, nor can we recommend the adoption of progression; for it will inevitably result in great loss of revenue, the poorer agriculturists being much greater in number than the richer ones. In effect, therefore, we shall have to leave alone those unfortunate payers of land revenue who are paying more than what is warranted by their ability. But taxation of the poorer people beyond their ability is no reason why the richer ones should pay less than theirs. Indeed these latter classes, whose pay-

[1] This cannot be said to be the case. The Taxation Enquiry Committee has suggested a number of taxes which the Provinces might well utilize. Moreover, if ever Indian Finance is to be placed on a theoretically perfect foundation, the Provinces will have to give up land revenue sooner or later. Land properly belongs to the sphere of local taxation.

ment to the State by way of land revenue is less than they would have had to pay as income-tax but for the exemption, are undeservedly escaping taxation. Subjecting them to income-tax would not amount to double taxation, but would only bring their payments to the State in accordance with their 'ability to pay'. Under the present circumstances, assuming the continued existence of land revenue, the only reform that can be suggested is to make the richer agriculturists pay in proportion to their taxable capacity, i.e., at the normal rates of income-tax and super-tax to which they would be liable if their income were non-agricultural. This can be done by subjecting them to a supplementary income-tax which will bring their tax payments in line with those of persons with equal amounts of non-agricultural income. In fixing the minimum, beyond which agricultural incomes should be brought under the tax, we should take into account the average incidence of land revenue. Assuming this average to be 10 per cent.[1] of the agriculturist's taxable profits, the payment of land revenue on all incomes below Rs. 30,000 will be made at a higher rate than that of the income-tax; it is only after Rs. 30,000 that the rates of income-tax rise sharply, and ultimately reach 29.3 per cent. in case of incomes over 6 lakhs of rupees. We propose, therefore, that so far as temporarily settled estates are concerned, agricultural incomes below Rs. 30,000 should continue to be exempt; but similar incomes above Rs. 30,000 should be brought under the scope of the income-tax. They should be taxed at the ordinary income-tax and super-tax rates on their

[1] The incidence of land revenue in Madras, according to the Taxation Enquiry Committee, averages somewhere about 17 per cent., in Bombay 22 per cent., in Punjab 17 per cent., and 10 per cent. in Berar. (vide pp. 76-77 of their Report.) These relate to net assets for Madras; and in Bombay, Punjab and Berar, they relate to rental value. The taxable incomes of the agriculturist which will be much greater than his land revenue income, as the former will include his subsistence, interest on his capital etc., may be roughly assumed to suffer by an average of 10 per cent. by payment of land revenue.

entire income ; but should pay to the State only the excess of such tax over the land revenue already paid by them. So that, under our scheme any person getting an agricultural income of more than Rs. 30,000 will pay to the Government an amount represented by the income-tax and super-tax calculated on his income, minus the land revenue paid by him ; e. g. if a land-holder has an agricultural income of Rs. two lakhs on which he pays a land revenue of Rs. 20,000, the income-tax and super-tax payable by him under our proposed scheme, at the present rates will be Rs. 32,813—Rs. 20,000, i.e. Rs. 12,813. Thus he will not be subjected to double taxation and, at the same time, his payment will be in accordance with his ability.

It should be pointed out, however, that this partial scheme for the taxation of agricultural incomes from temporarily settled lands, though removing the glaring injustice of richer men paying less tax, does not solve the problem of the poorer persons who are paying more. It also leaves undisturbed the flatness of the rate so far as incomes below Rs. 30,000 are concerned. Our whole scheme is however based on the assumption that the immediate abolition of land revenue is beyond the pale of practical politics. If, owing to a redistribution of functions and revenues on a federal basis, the provinces are ever in a position to give up their land revenue, a complete amalgamation of the agricultural incomes into the ordinary income-tax law must be preferred to the via media suggested by us.

Income from Permanently Settled Estates :—We have hitherto been dealing with agricultural income derived from temporarily settled estates. But there are a number of estates in this country paying land revenue which was fixed somewhere about the close of the 18th century. [1]

[1] Some estates were permanently settled also at the beginning of the 19th century, e. g Zemindari of Singampatti.

They are all zemindari estates, the land revenue being paid by the zemindars in whom the right of proprietorship over the land was vested by the East India Company. These estates are fairly big units, and are therefore not cultivated by the owners themselves; their income is mostly derived from the rents which they receive from their tenants. They are exempted from the income-tax under the general exemption granted to agricultural incomes.

At first sight, their case seems to be on all fours with those of the ryotwari holders of land for, like the ryotwari holders, the zemindars also pay land revenue. But there are certain fundamental differences which place the zemindar in an entirely different position.

First, it cannot be dogmatically asserted that the land revenue paid by these permanently settled zemindars is in the nature of a tax. The more reasonable conclusion seems to be that the revenue they pay to the State is not in the shape of a tax on their agricultural income, but is only a fixed annual commutation of purchase price paid for right of ownership in land. The zemindars were originally revenue collectors who were paid a certain commission in return for collecting and transmitting the revenue to the Central Government.[1] After the death of Aurangzeb in 1707, the Mogul Empire finally lost control over its distant provinces, and the erstwhile revenue collectors assumed airs of sovereignty, and retained the revenue they collected for their own use. Then came the grant of the Diwani of Bengal, Bihar and Orissa to the East India Company. The Company began farming the revenue by auction; in the bidding that followed, the original zemindars lost possession of the lands, and newcomers took their place. The ousted zemindars sent forth vociferous complaints to England, and managed to secure the favour

[1] For a brief discussion of the permanent settlement and the events leading up to it. See T. E. Committee's Report, pp. 40-42.

able attention of the Court of Directors. Then came the Permanent Settlement of 1797. These zemindars were declared proprietors of the land, subject to the annual payment of a fixed sum, which was not to be increased in the future. The sum so fixed amounted to 10/11ths of the original rental, so that the zemindars got 1/11th of the rental as their share. There is no doubt that when the settlement was made, the zemindars had certain rights; but these rights were only those of revenue collectors and even these rights had been suspended by the East India Company. For all practical purposes, therefore, they were not owners of the land, and had no right to such ownership when the permanent settlement was made with them; hence their willingness to pay as much as 10/11ths of the revenue to secure rights of proprietorship. The East India Company on the other hand, was in difficulties; they wanted a powerful and loyal class of supporters and the discontented zemindars were politically a great thorn in their side. The result was the Permanent Settlement. The zemindars became owners of the land subject to a fixed annual payment; the East India Company secured the powerful and loyal adherents it wanted. There can be no doubt of the fact that the revenue which the zemindars agreed to pay to the Company was essentially a contract price.[1] As such it could certainly not be called taxation. If this view is accepted, the exemption of these zemindars from income-tax meant, their exemption from all direct taxation whatsoever.[2]

[1] Cf. "The Regulations show the status of the zemindar solidifying from that of officer of state to that of proprietor of lands, and the notion of rent emerging from notion of land revenue"—Per Rankin J. in Emperor v/s P. C. Barua case 74 I. T. C. also "The fact is that, tempted by the income to be derived from the cultivation of the waste lands which according to some reports was more than one-third of the whole area, and by the offer of an interest in the soil itself, the zemindar entered into a gamble. The Company offered to convert him from an office holder to an owner in fee simple in return for a fixed price". Per Mullick J. in Dharbanga v/s Commissioner of Income-Tax, case 75, I. T. C.

[2] Our conclusions are supported by the Simon Commission which points

Second, the land revenue paid by these zemindars was fixed with reference to prices and general economic conditions prevailing more than a century ago. Because of this the effective share of the state to-day is less than 20 per cent. of their rental. On the other hand, land revenue assessments in the ryotwari tracts have been subject to periodical revision and increase. The result is that, as contrasted with the ryotwari landholder, the permanently settled zemindar has been allowed to enjoy untaxed a considerable amount of unearned increment. So that, even if the land revenue paid by the zemindar is in the nature of a tax, that portion of his income which came into existence after 1793 and therefore constitutes unearned increment has paid no tax. The exemption of a zemindar from the income-tax cannot therefore be justified on the ground of double taxation ; it gives him in fact a net gift amounting to the whole of his unearned increment.

Third, it cannot be said that the incidence of even that amount of land revenue which is actually paid falls on these zemindars. Doubtful owners of the lands they now legally own, they exact not only the land revenue but much more from their tenants, the hereditary cultivators of the soil, who probably have much more right to it than either the zemindars or the East India Company. The ultimate pressure of the tax undoubtedly falls, not on the landlords, but on these cultivators.

To sum up, the land revenue paid by the permanently settled zemindars is by way of purchase price and, as such does not amount to taxation. Even if it does partake of the nature of a tax to some extent, its incidence falls largely on the cultivators. Even if the incidence is on the zemindars, we have to remember that all the additions to their income since 1793, are positively unearned incre-

out that "in the provinces where there is a permanent settlement, land revenue has the same economic character as a mortgage or title rent". They admit that the exemption is not supported by fiscal theory; Report, Vol. II, p. 239.

ments which go absolutely untaxed. In other words, there is no justification for the exemption of these zemindars from income-tax.

As regards the pledge of permanent settlement, the Taxation Enquiry Committee has shown beyond all manner of doubt that it is no bar to an agricultural income-tax. Even if it is, the legislature has an undoubted right to redress a longstanding wrong, ancient though it may be, and the Permanent Settlement ought not to stand in the way of taxing the incomes of these zemindars. As a matter of fact, the Statutory Commission has suggested the taxation of their incomes.

The proposals we make with regard to these zemindars stand on a different footing from those for the owners of ryotwari land. The exemption from income-tax of rent or revenue from permanently settled land ought to be immediately repealed, and these zemindars brought under the scope of the ordinary income and super-tax. If our proposals are carried out, all permanently settled zemindars with incomes of Rs. 2,000 and above per year will be brought under the operation of the ordinary income-tax laws of this country. They should be allowed, however, to deduct from their *taxable income* the land revenue paid by them. It will be seen that the ryotwari landholders will be better treated, because they will be allowed to deduct the amount of their land revenue from the *income-tax* payable by them. In fact, our proposals contemplate an income-tax only as a supplement to redress the injustice of land revenue with regard to incomes from temporarily settled land. In the case of permanently settled estates, however, we recommend the levy of a regular income-tax in addition to the land revenue. This difference is made because the land revenue paid by temporarily settled agriculturists is really in the nature of a tax, which is not the case with reference to the permanently settled zemindars.

Alienated Land Revenue :—In addition to the agricul-

turists and the landholders who could at least ostensibly claim to have been already taxed, the law also exempts Jagirdars and holders of Inam lands from payment of income-tax on the land revenue assigned to them. The following table reveals the amount of income thus exempt from taxation :—

Provinces	Assigned revenue to Jagirdars and Inamdars Lakhs of Rupees
Madras	86
Punjab	37
Central Provinces	5
Burma	1
United Provinces	—
Bombay	114
Bihar and Orissa	—
Bengal	—
Assam	3
Western Provinces . . .	—

The figures are compiled from the various provincial reports on Land Revenue Administration. They exclude Service Inams which are granted to Patels and similar Government servants. Jagirdars and Inamdars are rewarded for their loyalty by assignments of land revenue or the grant of revenue-free estates; and there is no reason why they should escape all direct taxation; on the other hand, they constitute a peculiarly fit object for taxation. Hence this exemption of revenue received from land should be removed, and the Jagirdars should be brought under the operation of the ordinary income-tax law, similar to what we have proposed for the permanently settled zemindars.

Exclusion of Agricultural Incomes from 'Total' Income :—The exemptions which we have hitherto been

discussing were, with the exception of alienated land revenue, incomes which claimed double taxation as the ground for their exemption. The exclusion of agricultural incomes from the tax-payer's total income in calculating the rate of his income-tax cannot find even that defence; as a matter of fact, the Income-Tax Bill of 1918 made an attempt to remedy this obvious injustice, but the powerful landed interests succeeded in preventing its passage into law.

Under this exemption, the agriculturist pays income-tax on his non-agricultural income at a rate lower than what his total income warrants; at the same time, if his non-agricultural income is below Rs. 2,000, he is exempt on it, even if his agricultural income amounts to several lakhs of rupees. This is an unwarranted violation of the doctrine of ability to pay.[1] It should be therefore provided that henceforth agricultural income should be taken into account in calculating the assessee's rate of tax on his non-agricultural income. This should apply to all agricultural income, irrespective of the fact whether they are derived from temporarily-settled or permanently-settled estates.

Reforms suggested:—To sum up our recommendations regarding the existing exemption of agricultural incomes:—

1. So far as income from temporarily-settled lands are concerned, the exemption should be removed only in the case of persons with incomes above Rs. 30,000, who should be brought under the ordinary income and super-tax laws of the land. In effect, however, these persons will only pay the difference between the amount of income-tax properly payable and the land revenue now paid by them.

2. So far as incomes from the permanently-settled lands

[1] The Simon Commission have recognised the rank injustice of this procedure, p. 240.

and estates are concerned, the exemption should be entirely removed. All zemindars with incomes above Rs. 2,000 a year must be made to pay income-tax. They may be allowed to deduct from their taxable income the land revenue paid by them.

3. The exemption extended to Jagirdars and Inamdars must be annulled, and they should be subjected to income-tax just like other persons.

4. The exclusion of the assessee's agricultural income from his total income, by which is determined the rate of income-tax on his non-agricultural income, is entirely unwarranted, and violates the canon of ability. This exemption should be removed in all the cases where the non-agriculturists have incomes derived from land, and they should be taxed at rates appropriate to their total income.

ESTIMATED YIELD

Before proceeding to make any estimate of the revenue realisable from the taxation of agricultural incomes, we must point out that in the absence of authentic figures of agricultural incomes classified under income grades, any estimate is bound to suffer from a certain amount of error.

So far as the ryotwari and the temporarily-settled provinces are concerned, we may safely make the assertion that comparatively little revenue will be realised, even if the income-tax is extended to incomes above Rs. 2,000. But our scheme is designed to tax such incomes only above Rs. 30,000 per year. This reduces still further the amount of revenue which these incomes will yield. We may therefore hazard a guess that the total revenue which will accrue by the application of our scheme to the temporarily-settled lands will amount roughly to Rs. 75 lakhs. The basis of our assumption is fully explained in Appendix V. As regards the agricultural income of the permanently

settled zemindars, the following table reveals their net taxable income.[1]

Provinces	Total Zemindari Rental (Permanently settled)		
	Amount in lakhs	Land Revenue paid in lakhs	Net Remainder in lakhs
Bengal	1519	216	1303
Bihar and Orissa . .	1298	153	1045
Madras	251	50	201
Total .	3068	419	2549

The net taxable income thus roughly amounts to more than twenty-five crores. If we omit from this amount about Rs. 10 crores as belonging to persons entirely exempt, we get about Rs. 16 crores as the effective taxable income. The reasons for our assumption are explained in the footnote.[2] The maximum effective rate of both income-tax and super-tax combined is to-day 29·3 per cent. Many of the zemindars are persons who are liable at the maximum rate, but in all such estimates, it is better to err on the conservative side; we have therefore assumed that taxable zemindari income will be subject to an average rate of about 12 per cent. or 2 annas in the rupee. At this rate, zemindari incomes will yield Rs. 2 crores.[3] Similar figures are not available for the United

[1] Appendices I and XXVI Bengal Land Revenue Report, 1927-28.
Appendices I and XXXVIII Bihar and Orissa Report, 1923-24.
Statement 2 Land Revenue Report Madras 1921-22.
The figures of gross rental are obtained from the valuations made for purposes of local cess.

[2] The exemption of ten crores is arrived at by assuming that out of the 190 thousand zemindary estates, 100 thousand have an average income of less than Rs. 500 and fifty thousand an income of Rs. 1000 each.

[3] The rate of two annas in the rupee is a very modest estimate:— for much of the zemindary income is concentrated in a few hands. Cf. Mr. J. A. Habback, Director of Land Records, Bihar and Orissa. "The major portion of the landlord's assets goes in to the pockets of a comparatively few persons......at least half the assessable income is held by persons whose assessable income would be Rs. 50,000 or more", Vol. V, T. E. p. 165.

Provinces. We can however make a rough estimate that the yield will be not less than rupees fifty lakhs in these provinces.[1] From Assam we can expect a lakh of rupees.[2] The total revenue realisable from the permanently-settled provinces therefore amounts to Rs. 251 lakhs.

Assigned land revenue amounts roughly to Rs. 250 lakhs. If we assume that they will be liable at an average rate of 4 per cent. (because they are not so rich as the permanently settled zemindars), the tax realisable will amount to Rs. 10 lakhs.

We cannot estimate the amount of increased revenue which will be realised by the inclusion of agricultural income for purposes of determining the rate on the tax-payer's non-agricultural income. But when we remember that many middle class people have small agricultural incomes in addition to their other income and also that the zemindars have a good amount of non-agricultural income, we may guess that on a conservative estimate, the increased revenue yielded will be about 10 lakhs.

We can now estimate the revenue which will be realized if agricultural incomes are taxed on the lines suggested above.

From temporarily settled lands ...	Rs.	75,00,000
From permanently settled lands ...	,,	2,51,00,000
From assigned land revenue	,,	10,00,000
From change in rate	,,	10,00,000
	Total Rs.	3,46,00,000

In Madras more than 40 per cent. of the zemindari income is held by 13 persons most of whom are liable at the highest rate (Vide p. 13, Madras Land Revenue Settlement Report, 1921-22.)

[1] Shaikh Habibulla and Seth Bisweswar Dayal, representatives of the Oudh Taluqdars while opposed to the removal of the exemption of agricultural incomes agreed that an enormous sum of several crores of rupees could be realised by subjecting them to income-tax, Vol. IV, T. E. Report, p. 457.

[2] Vide Mr. Gimson, Commissioner of Income-Tax, Assam, Vol. V, T. E. pp. 394-395.

Thus the total realisable revenue will probably be more than Rs. three crores.[1]

ADMINISTRATIVE CONSIDERATIONS

The usual objection advanced against the removal of the exemption is that administrative difficulties will make impracticable any scheme for taxing agricultural incomes. This difficulty is completely met in our scheme, so far as the temporarily-settled ryotwari lands are concerned, because the number of persons who will be taxed will be so few and their incomes so well known. As for the permanently-settled lands, there will not be any difficulty either, as the Government keeps details of rent rolls in the zemindari tracts ; besides, revaluations are made every year for purposes of local cess. Official evidence given before the Taxation Enquiry Committee also tends to confirm our view regarding the practicability of the scheme.[2] Indeed, the task is so easy that a sub-divisional officer of Datkhira, Bengal, Mr. L. A. Latiff could easily estimate with great accuracy the agricultural income which will be liable to the tax in certain districts in case the exemption was removed.[3] Similarly, Mr. Montford, Commissioner, Central Division, Bombay, could estimate very approximately the tax realisable from his division by removal of the exemption.[4] We can therefore unhesitatingly declare that the

[1] The Simon Commission estimate an yield of Rs. 5 crores on the assumption that all agricultural income, both ryotwari or zemindari, should be taxed. The wideness of their scope makes their figure higher than ours.

[2] Cf. The evidence of Mr. Freemantle, Senior Member, Board of Revenue, U. P. "In the case of anybody, whose income from rent is Rs. 2000 and over it is very easy to assess," Vol. IV, T. E., p. 507.

Also Mr. Foley, Bihar and Orissa "It might be practicable for a taxing officer roughly to estimate whether an agriculturist's income exceeds Rs. 2000 or any other limit, Vol. V, T. E., p. 139.

[3] Vide a paper read by him before the 10th Indian Economic conference.

[4] Vide his evidence before the Taxation Enquiry Committee, Vol. IV, p. 437.

taxation of agricultural income is an entirely practicable proposition from the administrative point of view. [1]

SUMMARY

We may now sum up our conclusions regarding the exemption of agricultural incomes.

1. The exemption of agricultural incomes is defensible only on grounds of double taxation. There can be no double taxation unless the incidence of the two taxes are similar in their effects.

2. Agricultural income from temporarily-settled lands is undoubtedly taxed by land revenue, but the rates are regressive, and in the case of the richer landholders, the amount paid by them is considerably less than what they would pay under the income-tax. The logical remedy is the abolition of land revenue and the removal of the exemption, thus amalgamating agricultural incomes with the ordinary income-tax. But this might result in such a great loss of revenue as will make our proposals impracticable. In the alternative, therefore, it is recommended that so far as these incomes are concerned, the exemption should be removed only for persons with their annual income above Rs. 30,000. Even these persons whose incomes exceed Rs. 30,000 should be allowed to deduct the amount paid as land revenue from their income and super-tax.

3. So far as permanently-settled zemindary incomes are concerned, it is very doubtful if the land revenue paid by them amounts to a tax; even if it is, they have still a large amount of untaxed unearned increment. It is therefore recommended that in their case the exemption should be

[1] Cf. "with the elaborate machinery for the maintenance of land records, and for the administration and the collection of land revenue at his disposal, the Indian Collector is probably in a better position to estimate agricultural profits than the assessor in other countries"—Report of the Indian Statutory Commission, Vol. II, p. 240.

entirely removed and incomes of Rs. 2,000 and above brought under the income-tax.

4. In the case of assigned land revenue, the exemption is entirely unjust and ought to be removed, and Jagirdari income should be treated just like zemindary income.

5. Agricultural incomes should be included by all assessees in their total income on which is calculated the rate of the tax to be levied on their non-agricultural income.

6. It is estimated that these schemes, if carried out, will probably yield more than Rs. 3 crores.

7. Moreover, the scheme meets all administrative objections and is therefore an entirely practicable proposition.

CHAPTER VI

THE SCOPE OF THE TAX—OTHER EXEMPTIONS

In chapter IV, we gave a list of the incomes exempted from the Indian Income-Tax. Some of these exemptions are a result of specific provisions in the law; others are made under executive notification, and are published in Part III of the Income-Tax Manual.[1] The exemptions are not all found in one place in the Act, with the result that at first sight a wrong impression is conveyed of the scope of the tax; it is desirable that they should be brought together in the text of the Act itself, and that no exemptions should be made by mere executive ruling.

In this section, we have brought together all these exemptions and classified them under the following groups :—

1. Religious and Social exemptions.
2. Political exemptions.
3. Military exemptions.
4. Railway exemptions.
5. Exemption of income payable outside India.
6. Exemption of certain savings.
7. Exemption of casual receipts.
8. Exemption of the income of local authorities.
9. Exemption of tax-free securities.

We shall now deal with these in serial order, compare them with foreign practice where necessary, and finally comment on their desirability or otherwise in the Indian Tax system.

[1] They are made by the Governor-General under power given to him under S. 60 of the Income-Tax Act. Such discretionary power with the executive is an unwarranted encroachment on the privileges of the legislature; it is not found in any other country.

RELIGIOUS AND SOCIAL EXEMPTIONS

Incomes derived from property held under trust for religious or charitable purposes are exempted from payment of income-tax. Incomes derived by such institutions from voluntary contributions are also exempt, if they are to be used solely for religious or charitable objects.

The first point to be noted about the Indian practice is the absence of any provision from exempting contributions towards charity. If an individual makes a voluntary contribution to a charitable institution, the income is exempt in the hands of this institution, but the individual is himself taxed on it. This is rather unfair to the charitably minded individual who is taxed on an income which he does not enjoy. It is of course true, that, in theory, giving away any income in charity is only another way of spending it; and it had therefore no special claim to exemption. But if the State desires to encourage national income being spent in charitable objects, and that is obviously the intention underlying these exemptions, then its object will be more effectively carried out if the individual is allowed to deduct from his taxable income any amount that he may contribute towards charity. In order to prevent fraud under this head, it may be provided that no contribution will be recognised for the purposes of this Act unless it is made to bona-fide charitable or religious institutions, from which the assessee will derive no material benefit. If such a provision is embodied in the law, assessees will be encouraged to devote a part of their income towards such beneficial purposes.[1]

Second, the exemption of the income of religious and charitable institutions is restricted only to property-incomes. Incomes derived from business even if legally set apart for charitable purposes is not exempt from the

[1] The United States of America has a similar and even more comprehensive provision, cf. Revenue Act of 1926 Sec. 214 (a) (10).

tax.[1] The English practice is directly in contrast to this ; under it, profits of a trade carried on by a charity is exempt from income-tax.[2] To remedy this obvious injustice in the Indian Law, it will be sufficient if provision is made for the exemption of voluntary contributions, as recommended above.

Objection might be raised towards the whole scheme of exemptions under this head as unnecessarily reducing the revenue. So far as religious institutions are concerned, the practice of exempting their income has been a familiar thing in India even from ancient Hindu times.[3] There is no reason why the exemption should not be continued. As regards incomes devoted to charitable purposes, these purposes have been defined to mean relief of the poor, education, medical relief and the advancement of any other object of general public utility.[4] These objects, though generally laudable everywhere, are especially so in the case of India, because of the poverty and ignorance of the people. The state should in no way impede the diversion of national income into such channels.

Religious and social exemptions should therefore not only be continued but also extended on the lines suggested above.

POLITICAL EXEMPTIONS

The exemptions which we have collected under this head may generally be termed "Political" because they are either based on international usage or on the deliberate policy of the Government of India. Exempted incomes coming under this class are :—

1. Salaries and fees received in India by foreign con-

[1] In the matter of Messrs. Lachman Das Naraindas of Cawnpore, Case 85, I. T. C.

[2] Spaulding's "The Income-Tax in Great Britain and the United States" p. 174.

[3] Vide Indian Journal of Economics, October, 1927, p. 106.

[4] Addendum S. 4 (3) Income-Tax Act, 1922.

suls, representatives and consular employees, provided they are not Indian residents employed in that capacity.

2. Salaries of His Majesty's Trade Commissioners in India.

3. Official allowances received within the limits of British India by a duly accredited agent of a Prince or State in India; also the salaries and allowances paid by Indian states to persons deputed for training in British India.

4. Interest on Government securities held by ruling chiefs of India in a special non-transferable form as the property of their states.

5. Interest on the Mysore Durbar securities.

Items (1) and (2) conform to international usage for the same practice prevails in all the Dominions, Great Britain and the United States. No change is therefore recommended in the Indian position, but it is suggested that Indian incomes so exempted abroad ought to be brought within the scope of the Indian Tax.[1]

The next two items are peculiar to India and are based on the assumption that the Indian States are separate sovereign bodies. Apparently, similar British Indian incomes find reciprocal exemption in the Indian states.[2] It is, however, questionable whether it pays the Indian Government to exempt the interest on Government securities held by Indian states, as there is no corresponding advantage in return.[3] The interest on Mysore Durbar securities is exempted because the Mysore State exempts in return the interest on the Indian Government secur-

[1] The Indian Agent-General in South Africa and the Indian High Commissioner in London are now exempt. There is no reason why this should continue to be the case.

[2] Cf. Rule (4), p. 83, Mysore I. T. M.

[3] Under the circumstances, the Indian State People's Delegation displayed surprising ignorance in complaining to the Butler Committee that British India exacted its toll of income-tax on securities held by the Indian Princes as the property of their states.

ities.[1] The exemptions outlined above may therefore be left undisturbed.

MILITARY EXEMPTIONS

All the exemptions brought under this head are made by the Governor-General-in-Council under the authority given to him by section 60 of the Income-Tax Act. They mainly relate to the incomes, in one form or other, of the members of His Majesty's Military forces in India, the term Military forces meaning His Majesty's Naval, Military or Air forces, British or Indian, the Auxiliary forces, and the Royal Indian Marine.

The following incomes are exempted which relate entirely to persons in Military service :—

1. That portion of their income which is compulsorily deducted for payment to a mess, wine or band fund
2. Value of rations and money-allowances paid in lieu thereof.
3. Pensions and gratuities granted in respect of wounds received in action or in the performance of duties ; also gratuities granted to the widows of such officers as are either killed in action or die within seven years of injury received.
4. Pensions granted to those who are invalided from the service on account of bodily disability attributable to or aggravated by such service.

In addition to these, certain gratuities, the result entirely of topical causes, are also exempt. These are firstly retiring gratuities given to Royal Engineer Officers,[2] and secondly gratuities granted to Assistant Surgeons in military employment when they are declared surplus to the establishment.[3]

Contributions towards mess, wine or band fund and the

[1] S. (4) (IX) Mysore Income-Tax Regulations 1923.

[2] In pursuance of the Royal Warrant dated 25th April 1922.

[3] Under Army Instructions No. 516 of 1924.

value of rations form part of the personal subsistence of the individual concerned. They clearly increase his ability to pay. Their exemption not only contravenes the doctrine of 'ability', but also differentiates between different types of tax-payers ; because other assessees are not allowed to deduct personal expenses from their taxable income. It is therefore advisable that this exemption should be abolished at the earliest opportunity.

The exemptions of items (3) and (4) namely, war and disability pensions, have in their favour the existence of similar foreign practice ; Great Britain, the United States and the principal self-governing Dominions exempt similar "Military" incomes from their income-taxes.[1] Evidently, the exemption of disability and war pensions are customary to military service. While making no suggestion for their abolition, it may be pointed out that they increase the high military expenditure of the country.

The remaining exemptions noted above, such as retiring gratuities etc. were evidently meant to make retirement more attractive. That is no reason why Indian revenues should suffer. Exemptions of these incomes do not accord with 'ability' to pay and should henceforth be discontinued.

Most of the exemptions noted above thus form an undesirable feature of the Indian system. That they were all created under S. 60 by the Governor-General-in-Council, and not directly by the Act, strengthens our plea for divesting him of such discretionary powers. The incomes exempted under this head with the exception of war and disability pensions should be no longer allowed to enjoy their unjust privilege, but must forthwith be made to pay income-tax.

[1] Vide, Income-Taxes in the British Dominions, also Spaulding's "The Income-Tax in Great Britain and the United States", pp. 163-164. It may be here noted that in pre-war Prussia, such incomes were exempt from the Prussian Income-Tax, p. 40, Graduated Income-Taxes in Foreign States, H. M. S. O.

RAILWAY EXEMPTIONS

The exemptions under this head relate to the incomes of Railway employees. Gratuities paid to Railway employees on retirement or discharge from service are exempt; in the event of their being killed in the performance of their duty, the gratuities granted to their widows or children are also exempt. Further, extraordinary gratuities paid to Railway employees who are injured or killed while on duty are also free. The reason for these exemptions evidently seems to be sympathy for the railway employees who are killed when on duty. It may be pointed out that this sympathy need not take the form of such special exemption, as they tend to restrict the scope of the tax. All the same, the revenue lost is not very appreciable; and the incomes exempted belong to afflicted persons. The status quo may therefore be left undisturbed.

EXEMPTION OF INCOMES PAYABLE OUTSIDE INDIA

These are:—

1. Pensions, salaries and leave allowances of Indian employees paid in the United Kingdom.[1]

2. Pensions and similar allowances drawn from any Colonial Treasury.

We have already recommended that the scope of the income-tax should be so enlarged as to cover all "Indian"[2] income. We have also commented at length on the undesirability of these particular exemptions.[3] The only proper course therefore is to abolish them and bring those incomes under the yoke of the Indian tax.

[1] The word "Indian" is used not with reference to citizenship but to the fact that they are or they were in the employ of the Government of India.

[2] 'Indian' in the sense that it arises or accrues in India.

[3] See Chapter IV.

EXEMPTIONS OF CERTAIN SAVINGS

he exempted incomes described below are mainly ıgs, which contribute towards the accumulation of national capital. These exemptions provide en-agement to the saving habit, especially with reference ıe smaller investors. They are :—

Any sum not exceeding one-sixth of his total income the assessee pays to effect an insurance or a deferred ıity either on his own life or on the life of his wife ; any such sum paid as a contribution to certain roved' provident funds. Besides, sums compulsorily ıcted from the salaries of Government servants to e provision for their wives and children are also npt.[1]

The interest on deposits in the Post Office Savings k.[2]

The yield of Post Office cash certificates.

Interest on the securities held by certain Provident ds.[3]

he exemption of life insurance premia and amounts lar in nature is a well-established feature of the Indian em, being found even in the first Indian Income-Tax 860. It may be noted however that this allowance, it is really more in the nature of allowance than an nption, is not so universally prevalent as it is some-s supposed, there being not less than ten countries in ch it is absent.[4] At the same time, this cannot be sed to condemn the exemption, for there are almost

[1] All these sums are taken into account in determining the rate of the tax, S. 7 (1), Income-Tax Act, 1922, I. T. M. p. 108.

[2] I. T. M. p. 85.

[3] The Provident Funds referred to are those to which the Provident Funds Act of 1897 applies.

[4] They are:—Hungary, Switzerland, Denmark, Sweden, Norway, Italy. Spain, Bulgaria, Greece—Income-Taxes in Foreign States. The Report relates to the pre-war period. The United States of America is to-day another conspicuous instance.

as many countries granting such an allowance.[1] Its rationale is to be found in the fact that it exempts certain kinds of saving-incomes which are not literally enjoyed but contribute towards the accumulation of national capital. It is of course true that theoretically speaking there is no case for the exemption of savings. But as a matter of policy, especially in a country like India which is in such great need of capital, we might well adopt a different course. It is true that exempting life insurance premia differentiates in favour of only one type of saving;[2] but it is also true that it is the only form of saving which the authorities could trace; other forms of saving will be almost impossible to trace.[3]

The necessity for the continuance of this insurance allowance in the Indian system becomes still more evident when we remember that in India, earned incomes pay on the same scale as unearned incomes. This allowance for insurance offers an inducement to persons with earned income to make a provision for the future; and may properly be regarded as a sort of an apology for the absence of differentiation.[4] The figures of the amount of tax thus remitted under the Indian system are separately available only since 1923-24; they are given below:—

[1] Countries granting such an allowance are Great Britain, Canada, South Africa, the Commonwealth of Australia, the Australian States, pre-war Prussia, the different German States, Austria and Holland. Also cf. "Speaking generally an allowance for the life insurance premiums is a feature of the income-tax systems of the Dominions and of foreign countries". R. C. on I. T. p. 65.

[2] Q. 1641, Royal Commission on Income-Tax.

[3] Cf. "No other form of saving suggested to us as a fit subject for an income-tax allowance would be so simple to administer", Report of the Royal Commission on Income-Tax, p. 65.

[4] This in fact was the explanation offered by Mr. Gladstone when in 1857 he introduced this allowance in the British system which had no differentiation at that time. Appendix I Minutes of Evidence, Royal Commission on Income-Tax.

Year	Amount (Lakhs of Rupees)
1923-24	5·1
1924-25	6·4
1925-26	9·8
1926-27	10·5
1927-28	12·8[1]

The figures show an appreciable increase from year to year; while part of this increase might be due to the growing knowledge of the allowance, the rest indisputably demonstrates a growth in the saving habit. Taking the average rate of relief at about one anna in the rupee the amount of income thus exempted would amount in the year 1927-28 to about Rs. 205 lakhs.[2] Though infinitesimal from the point of view of Indian requirements, this is still an appreciable figure.

There are, however, several features in the allowances under this head which require reform. The insurance allowance is generally meant for the assessees with smaller incomes. At present, under the Indian practice, the maximum exemption allowed is one-sixth of the income and the rate of relief given is the rate appropriate to the assessee's total income. Obviously this means a greater loss of revenue to the State from the richer than from the poorer assessees. There is no reason why this should continue to be the case. Almost all the countries which grant the allowance limit it to a prescribed maximum.[3] Where they do not do so, as in the case of Great Britain,

[1] Compiled from Return I. A.; see India Income-Tax Report and Returns, 1925-26 and 1926-27 and 1927-28.

[2] The rate of relief is taken at one anna, as the rates of income-tax vary from 5 pies to 18 pies in the rupee; the average of these rates is about one anna.

[3] South Africa, Australia, and the several Australian States—£50, pre-war Prussia £30, Austria £17.

the relief is given only at one half the standard rate.[1] It is desirable that the Indian Government should not grant more relief to its tax-payers. It is therefore recommended that the mode of relief should be changed from deduction under income to deduction under tax; and the maximum amount of tax thus remitted should be restricted to Rs. 52. The relief represented by this figure amounts to one-sixth of the tax payable, by tax-payers with an income of Rs. 9999 at the rate of six pies per rupee. For persons with incomes below Rs. 10,000, the relief extends to more than one-sixth of their income; for persons with incomes above that amount the relief applies to a progressively smaller portion of their income.

In this connection it should be pointed out that it is not desirable to restrict the exemptions of contributions to provident funds only to those which are founded under the Provident Funds Act of 1897. Contributions to Provident Funds are entirely akin to insurance premia, and the British Royal Commission on Income-Tax has recommended that the employee should be allowed to deduct such contributions from his taxable income especially when he receives the benefit in the form of a pension.[2] The practice in the Dominions is also against such a restriction.[3] Moreover, the victims of this restriction are especially persons with small incomes.[4] The restriction should be therefore removed, and all contributions made to duly constituted provident funds ought to be exempted,[5] provided of course, that together with the insurance

[1] Vide section xii, Report of R. C. on I. T. This restriction applies only for insurance effected after 1916.

[2] Report of Royal Commission on Income-Tax, p. 70.

[3] In both South Africa and Australia, payments made to superannuation, sustentation, widow's or orphan's funds, are all exempt, I. T. in B. D. pp. 63 and 243.

[4] Some very vocal victims are school teachers—Question in the Legislative Assembly.

[5] The exemption once granted to provident funds constituted under the Provident Fund Insurance Societies Act, 1922, should now be renewed.

allowance, the tax deductable does not exceed Rs. 52. Similarly, the exemption of the interest on securities held by certain provident funds should be extended to all such duly constituted funds. The exemption of Post Office cash-certificates is largely for administrative convenience as most of the holders of such certificates are likely to have their total income below the taxable minimum. This exemption saves the trouble of refunds. The exemptions of interest on deposits in post office banks arises from similar considerations, the parties being mostly of average means.[1]

To sum up, the exemptions made under this head, while undoubtedly justifiable, require certain reforms. The allowance for life insurance should be restricted to a maximum figure of Rs. 52 to be deducted from the tax; this allowance should be extended to all Provident Funds.

EXEMPTION OF CASUAL RECEIPTS

The following receipts are not supposed to be income and are consequently exempt :—

(1) All receipts which do not arise from the individual's profession or business and are also of a casual and non-recurring nature.

(2) All capital sums received either in commutation of a pension or consolidated compensation or payment of insurance or Provident Fund contributions.

As regards the first item, the mere fact of casualness does not entitle exemption. The casual receipt should also be unrelated to the assessee's usual source of income.[2] This practice is in accord with the British Law which also does not tax such casual profits.[3] It is evidently

[1] Japan similarly exempts interest on deposits in the postal savings bank, co-operative societies and savings banks, 26th Financial and Economic Annual of Japan, p. 29.

[2] Commissioner of Income-Tax v/s Sir Purshottamdas Thakurdas case, 24 I. T. M. Vol. II.

[3] In regard to Chunilal Kalyandas, case No. 103, I. T. C.

based on the annual conception of income viz. that unless the source of income continues throughout the year the receipt is irregular and does not add to the individual's ability. The American law on the other hand taxes all such casual gains.[1] As a matter of fact, annual profits are made the basis of taxation, not because there is anything sacrosanct in the 'annual' concept, but simply because it conforms to popular practice and is also administratively convenient. If an individual receives certain casual profits during a year, he is undoubtedly in a better position to pay during the same year, and there is no reason in theory why these casual gains should not pay the tax. The only factor restraining us from recommending its taxation is the fact that if casual gains are taxed, logically speaking casual losses should also be allowed as permissible deductions. The loss from the latter will probably equal the gain from the former ; it might even exceed it by stimulating fraud and evasion.[2] Moreover, under the Indian Law, the net income left untaxed is not every type of casual income but only that part which has nothing to do with the assessee's regular business, so that the income exempted is not very great. We may therefore safely continue this exemption. At the same time, we may point out that it will be desirable to levy some special kind of taxation on these incomes, as they are generally windfalls and sometimes add enormously to the individual's ability.

As regards the second item, viz., capital sums received in commutation of pensions, payment of insurance etc., the position is different. Exempting these incomes, while simultaneously taxing pensions and deferred annuities, is to differentiate unfairly between two similar types of income. The absence of inheritance taxation in India, al-

[1] Spaulding ibid. Chapter IX.

[2] The same remarks also apply to profits from speculative transactions. At present they are not taxed unless they constitute the assessee's regular business.

ready referred to in the preceding chapter, aggravates the injustice. It will be better therefore if we adopt the Australian method and tax these capital sums on a certain percentage of their amount.[1]

EXEMPTION OF THE INCOME OF LOCAL AUTHORITIES

Incomes of local authorities are exempt in India. This exemption is not open to serious objections, as the incomes of local authorities often include rates and duties which are really the proceeds of taxes, and taxing such income will lead to double taxation. Local authorities in India have not yet undertaken wholesale schemes of public utility functions; hence, there is not much loss of revenue under this head. When, however, Indian municipalities and other local organizations begin to administer public utility works on a commercial basis, we might consider the advisability of taxing such incomes. For the present, the status quo might be left undisturbed.

EXEMPTION OF TAX-FREE SECURITIES

The total amount of securities thus issued amount to Rs. 141 crores[2] and the taxable income which is exempted amounts to Rs. 7.64 crores. Government securities in India are largely held by the very rich tax-payers, persons having an annual income of more than Rs. 50,000.[3] The loss to the Government is therefore considerable amounting to as much as Rs. 72 lakhs without even counting the super-tax, while persons well able to pay are thus exempt on a portion of their income. Even if the

[1] In Australia, "income" is defined to include 5 per cent. of the capital amount of a retiring allowance or gratuity which is paid in a lump sum. I. T. E. B. D., p. 236.

[2] The Indian Investors Year Book, 1928.

[3] For the year 1926-27 out of Rs. 50 lakhs collected from interest on the Indian Government securities, only 5 lakhs were refunded as belonging to persons whose incomes were below Rs. 50,000.

revenue lost by exemption is set off by the amount gained in the shape of a lower interest charge, the incidence of taxation becomes unequal. If the securities are not tax-free, the richer assessee will pay in accordance with his ability. If the securities are tax-free, the richer the assessee, the more tax-free securities he holds and the smaller the amount he pays. It is therefore highly desirable that such tax-free securities should not be issued in future.[1]

SUMMARY

We may now sum up our conclusions regarding the various exemptions from the Indian Income-Tax.

(1) Exemptions of incomes payable outside India and most of the "Military" exemptions should be discontinued.

(2) Exemptions of incomes devoted to charitable purposes should be so extended as to include the voluntary contributions of the tax-payer.

(3) Life insurance allowance ought to be restricted to a definite maximum amount; the same should apply to all provident funds.[2]

(4) Capital sums received by way of commutation of pension or insurance payment should be subjected to the tax to a certain extent.

(5) No more securities should be issued free of income-tax by the Government of India.

[1] Prof. Seligman has strongly condemned the issue of such tax-free securities; vide chapter on "Tax exempt Securities" in his "Studies in Public Finance".

[2] The All India Income-Tax Committee, 1921 made a similar recommendation.

CHAPTER VII

BASIS AND COMPUTATION OF INCOME FOR ASSESSMENT

In the preceding three chapters, we critically examined the scope of the tax with reference to both incomes liable and incomes exempted. When analysing the meaning attached to 'income' under the Indian Act, we observed that the income-tax was, generally speaking, a tax on net income. In this chapter we shall examine in detail how income is computed for purposes of taxation, that is, the basis of assessment, and the deductions allowed under each schedule. We shall then determine how far the Indian law distinguishes net from gross income, and suggest such changes as may be necessary to make it a tax on net income only.

BASIS OF ASSESSMENT

The ideal basis of assessment is of course that under which the income-tax paid by an individual is assessed on the income which accrues to him during that year. [1] It is however difficult to execute this idea in practice. An individual's income for the current year will not be known until the close of the year; and if the state scrupulously wants to tax him on his current year's income, it will have to wait till the succeeding year to collect its dues. The tax paid will then have no relation to the income of the year during which it is paid. The only way to preserve at least a nominal observance of the "Present year basis" is to tax the individual on his previous year's income in

[1] Cf. "We agree with those who have described the year of assessment as the ideal basis". Royal Commission on Income-Tax, p. 105.

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the first instance, and when his current year's income becomes known later, make the necessary adjustments. Even this has not proved successful in practice, the payments to and from the individual to the state proving more irritating to the tax-payer than the inconvenience caused under any other theoretically less equitable system. As a matter of fact, the 'Present year basis' with its 'Adjustment system' formed a part of the Indian tax for the four years preceding 1922, when it was abandoned as it was found unworkable.

If the 'Present year basis' is ruled out, there are only two other alternate bases of assessment. The individual can be taxed either on his profits of the previous year or on an average of his profits for a few preceding years. The following table sets forth the assessable income of the same individual under these two different methods.

Year	Profit or loss ± (Lakhs of Rs.)	Taxable income under the average system (Lakhs of Rs.)	Taxable income under the previous year system (Lakhs of Rs.)
1916	+10	—	—
1917	−10	—	—
1918	+12	—	—
1919	+13	4	12
1920	−15	5	13
1921	+27	3	nil
1922	+10	9	27
Total income for 1919-22	35	21	52

Analysing the results of the preceding table, we find that both the previous year and the average bases assessment have each some points in their favour.

The system of basing assessment on the average income of a number of years enables the tax-payer to set off against his profits all losses sustained by him during that entire period, so that in the ultimate result, he is only taxed on his *net* income. Under the previous year system,

on the other hand, there is no such automatic allowance, with the result that over a number of years, the assessee pays tax on an amount greater than what he has actually realised as profits during that period.

While the average system is thus superior to the previous year basis in this respect, it should be remembered that the taxable profits on the average basis for any one year are actually very different from the real profits for that year. When the individual goes on making increasing profits every year, his taxable income continually lags behind his actual income ; he is thus paying less when he can pay more. In periods of increasing losses on the other hand, his taxable income is, for the first two years, more than his actual income. Thus he pays more when he can only pay less. It is of course true that ultimately these increased profits and losses enter into the calculation of the individual's taxable profits. But the tax is certainly not well adjusted immediately in relation to his income. When his income is assessed on the basis of the previous year, on the other hand, the individual pays almost immediately after he gets his income, and ceases paying almost immediately after his losses exceed his profits.

Thus, we find that each of these alternate methods possesses an advantage which the other lacks. A system which would combine the advantages of both is undoubtedly preferable to either of the two. Such a combination is found in a system under which the tax-payer is assessed on his previous year's profits, being also allowed to carry forward his losses against his future profits. Under this system, no tax will be levied in case of loss till it is completely wiped out by profits ; further, the tax will be levied just at the time when the assessee is most able to pay.

We shall now analyse the Indian system. As we have seen in a preceding chapter, the assessee is taxed on his profits of the year preceding that of assessment. He can of course choose his own accounting period, but once

he has exercised his choice, he cannot alter it without the previous sanction of the Income-Tax Officer. It should be pointed out, however, that the Indian system does not provide for carrying forward losses against the profits of future years. Indeed the Income-Tax return specifically prohibits the deduction of losses sustained in former years.[1]

Before proceeding to examine critically the Indian position we may observe that in the United States of America, Great Britain and the self-governing British Dominions, the practice is to assess the tax on the profits of the preceding year.[2] Great Britain and the United States have made up for the defects of the previous year basis by allowing losses to be carried forward against future years' profits.[3] The practice is slightly more liberal in Great Britain, where the losses can be carried forward for six years, while in the United States they can be similarly carried forward only for two years.

It would thus seem as if in assessing income-tax on the profits of the previous year, the Indian system is quite sound and in accordance with foreign practice. It may be pointed out, however, that there is a certain section of Indian opinion which favours the 'average' system.[4] Their

[1] Para 37—Part III, Vol. I, Income-Tax Manual 1922.

[2] These facts are compiled from Spaulding's Study of the British and American income-tax systems, also from "Income-Taxes in the British Dominions".—H. M. S. O.

[3] Part IV, Finance Act 1926 (Great Britain). Also Cf. "If for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any tax-payer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the succeeding taxable year; and if such net loss is in excess of such net income, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year." U. S. Revenue Act, 1926.

[4] E. g. The Madras Chamber of Commerce, the Marwari Chamber of Commerce, Calcutta, T. E. Vol. VII p. 134 and Vol. V. p. 532. Also cf. "The benefit of such a rule might be considerably increased, if the merchants and traders, as well as manufacturers on a large scale are permitted to offer an assessment on the average of three or five years' profits". K. T. Shah "Sixty years of Indian Finance", p. 243.

advocacy of this system is rather half-hearted and they are ready to prefer the 'Previous year' basis, provided it is accompanied by a provision for carrying forward losses as in other countries. Moreover, the 'Average basis' is much more difficult to work,[1] and a major portion of commercial opinion favours the simplicity of the 'Previous year' system.[2] It would seem, therefore, that on the face of it the Indian position requires no alteration. But at present losses cannot be carried forward. When a period of depression intervenes between two periods of prosperity, the tax undoubtedly makes an encroachment on capital; e. g. if a business concern loses Rs. 10 lakhs during three years and gains Rs. 10 lakhs during the next three years, then, under the Indian system, its taxable income will amount to Rs. 10 lakhs for the whole period, whereas, as a matter of fact, the concern has made neither profit nor loss. The tax therefore falls on its capital. This particular problem is not a mere theoretical grievance; in India commerce and industry are to-day passing through a period of depression which is the aftermath of the war; years of gains are interspersed with years of losses, so that on an average, these concerns make much less profits than what they are assessed with for the income-tax. The following table, compiled from figures given in the Indian Investors' year book, shows the seriousness of the problem.[3]

[1] Vide evidence of Messrs. Gaskell, Middleton and Gimson (Commissioners of Income-Tax, U. P., Bihar and Orissa and Assam respectively), p. 54 Vol. III and pp. 184 and 385 Vol. V. Taxation Enquiry. Ibid.

[2] E. g. Bengal, Bombay and Burma Chambers of Commerce, the Bombay and Ahmedabad Millowners' Association, vide their evidence before the Taxation Enquiry Committee.

[3] This table is compiled from the figures given in the analysis of working of different companies. For details see The Indian Investor's Year Book, 1928.

LOSSES (IN LAKHS OF RS.)

Industry	1923	1924	1925	1926	1927	1928	Total No. of losing concerns
Coal . . .	1·3	0·5	0·7	2·2	5·0	3·6	27
Tea . . .	—	—	1·0	1·1	—	—	14
Jute . . .	—	—	2·1	40·3	—	—	9
Cotton . .	14·3	64·3	100·2	101·9	35·5	13·5	35
Total .	15·6	64·8	104·0	145·5	40·5	17·1	85

The commercial community has repeatedly pressed upon the Government the necessity for allowing losses to be carried forward. The Associated Chambers of Commerce have made a resolution on this subject, almost an annual feature of their conferences;[1] while the Federation of Indian Chambers of Commerce made a similar demand at their recent Annual meeting at Calcutta.[2]

As a matter of fact, when the Income-Tax Act of 1922 was before the Legislative Assembly, an amendment was moved to permit losses to be carried forward.[3] The Government asserted in reply that it would be against the spirit of the Indian Act which assessed the profits of a particular period regarded as entirely isolated.[4] The ans-

[1] The resolution ran thus:—"That this Association urges on the Government the necessity of recognising the equity of making provision for business losses when computing income-tax...... The Association recommends that it should be made permissible for an assessee to carry forward losses for a period of three years". It was passed at their annual general meeting on 30th January, quoted in B. C. C.

[2] The resolution was initiated by the Marwari Chamber of Commerce, Bombay, and suggested that "assessees be entitled to carry forward for an adopted period of six years losses in business sustained in any year as a set-off against the profits of such subsequent years", Proceedings of the Second Annual Meeting of the Federation of Indian Chambers of Commerce and Industry, pp. 113-119.

[3] By Lala Girdharilal Agarwala, L. A. D., Vol. II, Part II, pp. 1921-22.

[4] "At present we assess the profits of a particular period of 12 months... The profits of that period are considered by themselves. They are entirely isolated without any consideration of what went before or what comes after". L. A. D. Ibid. The amendment of Lala Girdharilal was defeated.

wer did not really meet the objection. It is certainly not the aim of the Income-Tax Act to tax capital; and yet the Government position in effect amounts to a taxation of capital.

It must also be remembered that when the British Government replaced the 'average' by the 'preceding' year basis in 1926, they made a concurrent provision for carrying losses forward to a period of 6 years. The United States of America, as we have seen, has a similar provision though losses cannot be carried forward for more than two years following the year of loss.

The Taxation Enquiry Committee after a careful examination of this problem recommended that a loss sustained in any one year should be allowed to be set-off against the profits in the next subsequent year only.[1]

We can, therefore, confidently assert that the absence of a provision for allowing losses to be set off against future profits seriously mars the equitable incidence of the Indian tax. The grievance is undoubtedly genuine and needs an immediate remedy. Provision must, therefore, be made for allowing losses to be carried forward against future profits. The next question to be considered is the number of subsequent years against the profits of which the losses should be allowed to be set off. The British law provides for six years, the American law for two years, and the Taxation Enquiry Committee has recommended one year. Considering the fact that under an assessment on the average of three years' income, losses only for two years could be set off against one year's profit, the adoption in toto of the British practice is not desirable; we may, however, follow the American law and provide for losses to be carried forward to the succeeding two years. An adoption of this scheme must be accompanied by stringent provisions against fraud. No allowance must be granted under this head unless complete accounts are produced for

[1] Taxation Committee's Report, pp. 190-191.

the preceding year, and the Income-tax officer is convinced of the reality of the loss.

COMPUTATION OF INCOME

As we have already noted in Chapter IV, it is only in the case of income from property and business that net income is distinguished from gross receipts. In computing these two kinds of incomes for purposes of assessment, the law permits certain specific items of expenditure to be deducted from the gross profits. We shall examine below the nature of these deductions and how far they carry out the ideal of the taxation of only net income.

Computation of Income from property:—The deductions allowable under this head have been already described in detail, and we shall now briefly summarise them :—

(1) One-sixth of annual value in lieu of repairs.
(2) Insurance charges.
(3) Ground rent and interest on mortgage on the property.
(4) Land revenue.
(5) Collection charges not exceeding 6 per cent.
(6) Allowances for vacancies.

The aggregate of allowances under this head are not to exceed the annual income from the property. This means that there can be no net loss under this head ; otherwise, persons owning old and decayed houses will set off losses under such property against their other profits. This provision, though in a sense hard on the owners of hereditary decayed houses, is salutary as it will discourage persons keeping up uneconomic property.

Of the deductions allowed under this section, land revenue, insurance and collection charges are all normal items of necessary expenditure. Similarly, there is no doubt that in houses which are usually let, vacancies do reduce the annual income. Only three items deserve special mention.

The allowance for repairs is made in a peculiar way. The amount allowed is not the actual cost of repairs; but one-sixth of the annual income from the property; and it always accrues to the owner. Even if the tenant undertakes the cost of repairs, the owner is paid an allowance equal to the difference between the rent he receives and the annual value of the property, as estimated by the Income-Tax Officer. It seems, therefore, that this allowance is meant not only to cover repairs, but also includes a concealed deduction for depreciation. Such a procedure is not correct, even though it is true that houses do suffer in value from continuous use and need a depreciation allowance. The proper course would be to restrict the allowance for repairs to the actual cost, and at the same time make an additional allowance for depreciation. The life of the property should be estimated after taking into account the fact that it will be kept in good repair; the prime cost of the building to the owner should be divided by the number of years thus estimated; and an annual depreciation allowance should be made on that basis.

Secondly, while the allowance for ground rent is entirely reasonable, it is difficult to see why the assessee should be allowed to deduct the interest on his mortgaged property. While it is true that such payment of interest is compulsory on his part, it is certainly not true that it is incurred solely in the process of earning that income. The mortgage may be due to expenditure for improving the property; it may also be due to expenditure incurred by the owner for a holiday tour to England. The first is an admissible charge on the increased annual value; the second is essentially a personal expense. Personal expenses of the assessee are specifically prohibited from being deducted in the case of income from all other sources. There is no reason why income from property should be given this exceptional treatment. We, therefore, recommend that interest on mortgage should not be allowed as a de-

duction from assessable income, unless the loan has been raised for improving the estate. The onus of proof that the proceeds of the loan are so spent should lie on the assessee.

Thirdly, no deductions are permitted on account of municipal rates or other local taxes on the property. It is generally reasonable that this should be so; except where the rate is paid in return for a direct quid pro quo. In such cases, e. g. water-rates, the annual value is increased on account of the services secured by such payment. There is no reason why these rates should not be regarded as an item of business expense and therefore an admissible deduction.[1]

We come to the conclusion that so far as property income is concerned the present system leads to the taxation of something more than net income. The following suggestions are made to remedy the situation.

(1) The present allowance for repairs should be replaced by one equal to the actual cost of such repairs.
(2) An annual depreciation allowance should be granted.
(3) Interest on mortgage on the property ought not to be allowed as a deductible item unless the mortgage is raised for purposes of improving the estate.
(4) Water-rates and similar local rates paid in return for a direct service should be allowed as legitimate deductions.

Computation of Income from business :—The expenses allowed under this head have been already classified under three heads[2] :—

(1) Ordinary expenses of production.
(2) Depreciation and obsolescence.
(3) Depletion.

[1] Water-rate for a house which is usually let is certainly not a personal expense on the part of the assessee. Sir George Lowndes expressed a contrary view.—Financial Statement, 1918.

[2] Vide Chapter III for a detailed description.

Ordinary expenses of production:—As regards the ordinary expenses of production, practically no comments are necessary. They are all expenses which are necessarily incurred for the creation of the income. Only one item deserves notice, viz. deduction of interest. It is provided that no deduction shall be made by way of interest, if such interest is payable in the shape of a share of the profits. This provision is made in order to distinguish money that belongs to the owners of a business and money that is borrowed by them from outside.[1] This however results in occasional injustice. Thus, where interest in the shape of a share of the profits is given in respect of a genuine loan transaction, the borrower has to pay income-tax at a rate higher than that suited to his actual income; further, he might even have to pay a tax on money which he never enjoys, as the law does not authorise him to deduct the tax from his creditor's share. The instance quoted above is not merely theoretical; there are certain money-lenders known as "Mudhi bhagidars" who lend money, receiving interest in the shape of a share of the profits, but who are not responsible for any losses.[2] Such interest is a genuine expense of production and ought to be allowed as a deductible item. It is not necessary that the law should be recast, but special instructions may be issued under the Act to meet such cases.

Depreciation and obsolescence allowances:—Allowances for depreciation are made because fixed capital employed in the business—such as buildings, machinery, furniture and plant—tend to wear out physically through prolonged use. The depreciation in their value due to this wear and tear has to be met from the profits of the concern; and is therefore a legitimate charge on its gross profits.

[1] Vide Mr. Sim's reply to Rai Mansingh's amendment to remove the proviso, L. A. D., Vol. II, part II, pp. 1923-1924.

[2] Vide Case 93, I. T. C.

Obsolescence allowances are necessary because with the steady growth of invention and industrial progress, plants and machinery become obsolete and have consequently to be discarded. The cost of their renewal is properly chargeable to profits.

The Indian position:—In India, depreciation allowances are made in respect of buildings, machinery, plant and furniture *owned* by the assessee and used in his business. The allowance is given in the shape of a prescribed percentage on the original cost of machinery to the assessee. It is provided that in no case shall the sum total of the allowances exceed the original cost. If the allowance for the year exceeds its assessable profits from that particular business it may be carried over to the succeeding years. The allowance in respect of buildings is confined only to property used in business. We have elsewhere pointed out the need for the allowance being extended to all house property.

As regards fixed capital whose life is too small for depreciation allowances and which have to be repeatedly renewed (chairs, pencils, pens etc.), the expenses of renewal are allowed to be deducted from the assessable profits.

Obsolescence allowances are made only in respect of plant and machinery ; the amount allowed is the difference between the original cost of the machinery to the assessee as diminished by the depreciation allowances and its scrap value.

It is inequitable that the depreciation allowance should be given only in case where the assessee *owns* the buildings and machinery, which is used for his business. When the assessee is a lessee of a building—which often does happen to be the case in actual practice—neither the owner nor the lessee obtains the depreciation allowance. It is really the lessee who is the sufferer, as the fact of depreciation is taken into account by the owner when fixing up

the lease value. This results in an unjust differentiation of his business from that of one who has his business in his own house. The only way to solve the problem is to permit depreciation allowances for all buildings and house property as recommended in the previous section ; it may also be provided that where the assessee has hired machinery on a long lease, the depreciation allowance may be given to the lessee himself.[1]

Coming to the actual allowance there are four ways in which depreciation allowance can be given. They are[2] :—

(a) Depreciation on diminishing value.
(b) A fixed ratio of the original cost.
(c) A certain amount to be written off each year, to be so determined that together with interest, the instalments will amount to the original cost.
(d) The amount written off each year to be equal to the actual loss in value caused by depreciation every year ; the sums of all these allowances being finally equal to the original cost.

The last method seems to be attractive from a theoretical point of view. It makes the allowance smallest when the machinery is new and consequently the depreciation small ; it makes the allowance largest when the machinery is old and consequently the depreciation large. But it involves minute calculations which are very complex and may not even be possible in all cases. It will introduce needless confusion and its theoretical advantage will be more than offset by its complexity and novelty.

The first method is the worst to adopt, as its effect is opposite to that of the fourth method ; it makes the deductions greatest when the plant is new, and when in fact

[1] Cf. The English practice, "Where machinery is let to a tax-payer on terms that he shall maintain it and deliver it in good condition at the end of the lease, he is deemed to be the owner". Spaulding, Ibid., p. 188.

[2] Royal Commission on Income-Tax. Q. 8642-43, Evidence of Prof. Henry Louis.

it depreciates least rapidly. It may therefore be rejected summarily.

As between the second and third methods, the third is undoubtedly preferable. It is obvious that under the second method—which makes no provision for interest—the assessee finally gets an allowance that is in effect larger than the original prime cost of the machinery; e. g. if a piece of machinery, whose life is estimated at 5 years, cost originally Rs. 100,000, the depreciation allowance under the second method will amount to Rs. 20,000 per year. Assuming the market rate of interest to be 6 per cent., the assessee will realise at the end of 5 years Rs. 100,000 plus Rs. 18,000 more as interest on the five instalments.[1] The third method in this same case, would lead to an annual allowance of Rs. 16950.[2] The second method is thus more costly to the state, while at the same time it has no superiority over the third on grounds of simplicity. The Indian system is based on the second method detailed here; and undoubtedly causes much loss to the state. It is, therefore, necessary that the Indian practice should be revised; and the annual depreciation allowance should be henceforth so calculated as to include interest realisable on the instalments thus allowed.

In case the assessee has more businesses than one, say A, B & C, then the depreciation allowance for A can be set-off only against profits from A.[3] If A yields no profit for the year, and B & C yield him profits, he has still to carry the depreciation allowance forward to the

[1] At the rate of 6 per cent. he will realise
Rs. 6000 on the 1st instalment.
Rs. 4800 ,, 2nd ,,
Rs. 3600 ,, 3rd ,,
Rs. 2400 ,, 4th ,,
Rs. 1200 ,, 5th ,,
Total Rs. 18000

[2] Together with the interest on it, this amounts to Rs. 100,000 at the end of 5 years.

[3] Vide Sunderam, p. 502, ibid.

next year and meet it out of profits from A. In connection with this procedure, it may be pointed out that the Act taxes the total income of the assessee and not his income from each individual business. In justice, therefore, he should be allowed to lump the several depreciation allowances due to him and set off the resulting sum against his annual profits.[1]

The allowance is confined only to tangible fixed capital. This is in conformity with English practice. But the United States of America grants depreciation allowance even in the case of intangible capital provided such capital is definitely limited in duration and is used in the business. Thus patents, copyrights, licenses, franchises[2] and leaseholds may be the subjects of annual depreciation allowances.[3] It is difficult to understand the rationale of such an allowance, as intangible things like patents etc. can have no physical depreciation, and the depreciation allowance is primarily meant to cover the loss in value caused by physical wear and tear. Hence there seems to be no need for a depreciation allowance for these intangible types of capital. The Royal Commission on Income-Tax was also not in favour of any such allowance.[4]

(5) As regards obsolescence allowances also, the Indian practice is in conformity with the practice in the Dominions and Great Britain, inasmuch as the allowances are restricted to tangible fixed capital. This case is however different from the depreciation allowance. Intangible things do not wear out physically, but they do become

[1] Cf. The Royal Commission on Income-Tax has recommended that depreciation and obsolescence allowances should be regarded as trade expenses. This obviates the necessity of carrying them forward, such losses being treated like any other trading loss. Report, pp. 49-50.

[2] Such as sole rights to use a particular track in the case of railways, tramways etc.

[3] Vide Spaulding ibid. pp. 184-185.

[4] It is interesting to note that the chief self-governing dominions also restrict their depreciation allowances to tangible capital, Vide Income-Taxes in British Dominions, H. M. S. O.

obsolete. Let us assume the case of a businessman who has the monopoly of a patent which doubles the yield of his machinery. After a few years, the right of using the patent ceases to be the subject of a monopoly ; and it has to be thrown open to all. This removes the special advantage which the owner of the patent had over his competitors. The loss thus caused is a definite business loss and is certainly a fair charge on the profits ; if it is not allowed as a deduction, the tax will encroach on capital. The obsolescence allowance in India should be therefore extended so as to apply to these intangible kinds of fixed capital, provided of course they are used in the assessee's business.

We may now sum up our recommendations regarding depreciation and obsolescence allowances :—

(1) The annual instalments given by way of depreciation allowance ought to be so calculated that they take into account the interest realisable on them.

(2) The depreciation allowances should be allowed not only when the buildings and machinery are owned by the assessee, but also when he has hired them on lease.

(3) The assessee should be allowed to treat depreciation allowances as business expenses, and permitted to set them off against his total profits.

(4) The obsolescence allowances should be extended to cover intangible fixed capital such as patents etc.

Depletion allowances :—There are certain business enterprises which involve wastage of capital, i. e. in the very process of the creation of their incomes, the capital of the concern is destroyed, e. g. the natural industries, such as coal-mines, oil wells etc. Deductions are therefore made for depletion so that the taxable profits of such concerns is arrived at only after the net capital invested is fully allowed for.

The Indian position :—No depletion allowances are

permitted in India; and mines and oil companies are taxed on their entire profits. When examining the case for the introduction of such allowances in India, the following facts should be borne in mind.

(1) There is no uniformity of practice regarding this allowance abroad. While the United States of America and some British Dominions allow such deductions, Great Britain and some other Dominions refrain from making any such allowance.[1]

(2) Mines, oil-wells and similar underground sources of wealth have always belonged to the nation. The capital destroyed in the course of the working of the mines is thus really the nation's capital; and there is no reason why the capitalist of the mining industry should get any allowance for the loss of a thing which is not his own. As for the lease value that he has paid, it is more than compensated for by the immense profits that he makes out of the mines. Indeed, public opinion in the West regards profits from mines as a peculiarly fit object for taxation.[2]

(3) After a full consideration of the problem, the British Royal Commission on Income-Tax has definitely recommended that no allowance should be granted to incomes arising from wasting assets which consist of the proprietorship of natural resources in the country.[3] Moreover, in case such an allowance is granted, the life of the mines will have to be determined and the quantity of mineral contents estimated. These involve costly expert assistance and even then, the results are not satisfactory; and the allowances might have to be frequently revised.[4] Indeed the administrative difficulties of calculating and deducting the appropriate allowances will be well nigh insuperable.

[1] Vide Spaulding ibid, and Income-Tax in British Dominions.

[2] Vide "Income-Taxes in British Dominions", H. M. S. O.

[3] Vide Report Royal Commission on Income-Tax, pp. 43-45.

[4] For a full discussion of the difficulties attending this allowance in the U. S. A. see Spaulding, Ibid. pp. 177-183.

(4) Lastly, the loss of revenue resulting from the grant of any such allowance will be considerable. In 1926-27, there were 58 coal companies having a taxable income of Rs. 2 crores, and 27 oil companies having a taxable income of Rs. 8.6 crores.[1] Their total income thus amounts to about Rs. 11 crores out of the total of 49 crores belonging to companies paying super-tax. In other words, they account for about 20 per cent. of the taxable income of companies in India, and therefore any allowance for depletion will reduce the yield of the tax by an appreciable figure.

When we consider all these facts, it is clear that under our present circumstances, no case has been made out for the grant of depletion allowances to income from mines and oil-wells. In the case of income from annuities, however, the position is different. The amount of such income in India does not reach any considerable figure; at the same time, the beneficiaries are generally the comparatively poorer classes. It is therefore advisable that an allowance for depletion should be permitted in the case of income from annuities.

DOES THE INDIAN SYSTEM ENCROACH ON CAPITAL?

We may now discuss the question whether the Indian Income-Tax taxes the individual on more than his net income; in other words, whether it amounts to a capital levy. Our previous discussions clearly reveal the fact that as it stands to-day, the Indian tax goes beyond net income and reaches capital in so far as certain types of incomes are concerned.

Firstly, the absence of allowance for losses shifts the incidence of the tax from business incomes to business capital, especially when the concerns are making steady losses.

[1] These figures are calculated from the classified receipts of super-tax return—All India Income-Tax Report, and Returns (1926-27). They relate only to companies with their annual incomes above Rs. 50,000.

Secondly, the unnecessary restriction of the depreciation allowances to buildings and machinery *owned* by the assessee together with the absence of obsolescence allowances for tangible capital, tends to shift the tax on to capital.

Thirdly, so far as incomes from annuities are concerned, by allowing no deductions for its capital element, the Act undoubtedly taxes the assessee's capital.

We have already discussed the measures which will remove this cardinal defect, and transform the income-tax into a tax on net or real income. They are summarised below :—

(1) The tax-payer's income should continue to be assessed on the previous year's profits, but a provision should be made for carrying the losses forward against the profits of two years following the year of loss.

(2) The allowance for repairs under house property ought to be the actual cost of repairs, and not one-sixth of the annual value as at present. Separate depreciation allowance should be provided for house property.

(3) When fixing the instalments allowed under depreciation allowances, interest realisable on them should be taken into account; further these allowances should be extended to all buildings and machinery, irrespective of the fact whether the tax-payer owns them or not.

(4) Allowances for obsolescence ought to be extended to intangible capital, such as patents etc.

(5) No depletion allowance ought to be granted in the case of income involving wastage of capital except in the case of annuities.

(6) Interest on mortgage on property ought not to be allowed as a deduction unless incurred for improving the estate.

CHAPTER VIII

Personal Allowances

We have hitherto been considering the Indian Income-Tax from what may be termed its *impersonal* aspects. Thus, we had studied the scope of the tax, the incomes liable and exempted, the inclusion of the 'psychic' element in the income concept, and the basis and computation of income for purposes of assessment. In this and the succeeding chapters we propose to deal with the *personal aspect* of the Indian tax. The way in which the individual spends his income, the way in which he earns it, and its total amount are all factors which undoubtedly influence his ability to pay. Equality in the amount of income is no sure index of equal 'ability' ; if the circumstances are unequal, 'ability' will differ correspondingly.

One of the most important of the various causes of difference in ability is the amount of necessary expenditure an individual has to incur. It is a truism to assert that a bachelor has more 'ability' than a married man ; because the bachelor has a greater surplus over his necessary expenditure than his married colleague. The same argument applies to those with children, and those without them. Such differences in 'ability' are usually recognised in modern income-tax systems by specific deductions from assessable income to cover the corresponding decrease in ability. These deductions are known as Personal Allowances, and form the subject of this chapter.

Personal allowances, however, do not merely include allowances for marriage, and children. In all the income-tax systems of the world, a certain minimum amount of income is exempted from the tax, and often allowed as a

deduction from the higher assessable incomes. This deduction is often assumed to correspond to the individual's minimum cost of subsistence ; and in recent days, we have the further plea for the exemption from taxation of a minimum of civic efficiency. A little thought on the subject is sure to reveal the essential unsoundness of such an assertion. Nowhere in the world does the income-tax minimum correspond to the minimum of subsistence, and it must be added that the incomes below that minimum do pay a considerable amount by way of indirect taxation. To argue that the income-tax minimum exempts the minimum of subsistence is to ignore the existence of indirect taxation ; and least should this be the case in British India, where the income-tax forms only a negligible portion of the combined Imperial and provincial revenues.

An exemption from direct taxation however does exist under all income-tax systems, though the reasons for it may not be the same as alleged by its fondest advocates. We shall consider the question of the exemption in this chapter, firstly because it forms a *personal* exemption, and secondly because it is frequently asserted that allowances for marriage, and children are both included in the present Indian exemption.

The exemption limit :—The exemption limit in India is placed at Rs. 2000 a year. No person is liable to the tax unless his annual income is or exceeds Rs. 2000. This exemption of Rs. 2000 however has no corresponding abatement for incomes above that amount ; and individuals whose incomes are Rs. 2000 or above pay income-tax on their entire income, and not merely on the excess above Rs. 2000. At present, therefore, the Indian exemption limit is not a regular personal allowance.

There are two questions to be considered with regard to this exemption :—

(1) Should it be allowed to retain its present character of being merely an exemption limit or should it be

transformed into a regular personal allowance, the amount exempted being allowed as an abatement from the higher incomes.

(2) Should the limit be left unaltered at Rs. 2000 or should any change be made either in the direction of increase or decrease.

The first question is closely connected with the problem of graduation, as a personal allowance of such a character alters the effective rate of the tax. Beyond pointing out the necessity for transforming the exemption into a personal allowance more especially in the interests of those whose incomes are immediately above the exemption limit, we shall leave the question open for discussion in the chapter on graduation.

As regards the amount of the exemption, we may point out that this question also involves a consideration of the question of an allowance for married people and one for those with children. Theoretically it is true that bachelors have a greater basic ability to pay than married people, and the Indian income-tax by providing a uniform exemption makes no allowance for this difference in ability. At the same time, one need not make a fetish of a lower exemption limit for bachelors. Unlike the west, where prolonged bachelordom has become an established institution, marriage is almost universal in India and it is difficult to find many bachelors above the age of 24. Thus out of the 2,50,000 persons with incomes below Rs. 10,000 it can be estimated that 25,250 are bachelors.[1] It is far more feasible to fix an exemption limit suited to 2,24,750 persons rather than fix one suited to 25,250 persons, and grant an allowance for the numerically stronger group.

[1] According to the Census of 1921, there were in India 58 lakhs of unmarried males and 514 lakhs of married males between the ages of 25 and 60. Assuming that bachelors are in the same proportion among the income-tax paying classes as they are in the general working population, we may estimate that in 1926-27, there were 25,250 bachelors out of 2,50,000 assessees with their total income below Rs. 10,000.

The proper way of taxing the comparatively higher 'ability' of the bachelor is not to begin with a lower exemption, but to give him the same exemption as his married colleague and in addition impose a special tax or fee on him. Such a tax would be financially unproductive, and at the same time, definitely undesirable from the point of view of social expediency and the universality of marriage in this country. Considering all these points of view, it will be better if no special attempt is made to tap the bachelor's greater ability; the little injustice which this undoubtedly condones being more than made up by the higher good to the community which it entails. There is, therefore, no need for a special allowance for married people.

The case for children allowances stands on a different level. The cost of maintenance might be included in the exemption limit, but there is the additional cost of educating the children which has to be taken into account. This special expenditure reduces the individual's taxable ability and should be recognized by the grant of a special allowance.

Before proceeding to discuss the details of this allowance, we may determine the amount at which the exemption should be fixed. This limit depends not only on considerations of justice in incidence and the accompanying burden of indirect taxation but even more on administrative considerations. The limit should be such as will result in the yield of a substantial revenue to the exchequer without an exorbitant cost of collection.

From the point of view of justice Rs. 2000 seems a fairly good limit. It is not possible to give a detailed idea of the incidence of indirect taxation on the incomes below Rs. 2000, but it may be pointed out that at present, such incomes pay the salt tax, the import duty on sugar, matches, cloth and silver, and the excise duty on kerosine. And

in addition, there are the provincial excise duty on liquors, the stamp and registration duties, and the local house and terminal taxes. Under the circumstances, we may best leave the exemption minimum at its present level.

Administrative considerations lead us to the same conclusion. Incomes between Rs. 1000 and 2000 are very difficult to assess accurately. They belong in the main to petty traders and shopkeepers who keep no accounts, and do not even know how to fill up returns of income. The Act of 1918 had, therefore, to provide for summary assessment in their case. As a matter of fact, one of the chief reasons for the comparative efficiency of the Income-Tax Department to-day is this exemption of incomes below Rs. 2000. Lowering the limit will greatly increase the work of Income-Tax officers and divert their efforts from the higher and more productive incomes to these lower and less productive grades. Thus, administrative considerations are also in favour of the retention of the present exemption limit.

ALLOWANCES FOR CHILDREN

Before proceeding to determine the exact amount which should be permitted as a special allowance for children, we may consider below the two usual objections advanced against such schemes.

(1) It is said that the grant of such allowances will encourage an increase in population,[1] the underlying implication being that over-populated India cannot stand any more strain on her food resources. There are two or three fallacies underlying this assertion. It is very difficult to believe that the income-tax paying people (who

[1] Cf. Prof. Solomon's evidence before the Taxation Enquiry Committee. "Relief granted for children may be additional incentive to the exercise of the already too strong procreative instincts of the people". p. 138, Vol. III, T. E.

are generally literate persons and town-dwellers) should deliberately increase their families with a view to getting the allowance. Again, even if they so increase, they do not belong to the C3 section of the people but form the middle classes—the backbone of the country. Thirdly, any increase, consequent on the allowance given to these people who number only about 250,000, will be little more than an infinitesimal addition to the general population. However, to meet all objections, it may be provided that no tax-payer will be allowed to claim relief on more than six children.

(2) The second and more important objection relates to the administration of the allowance. It is said, and not without justice, that if relief is given to dependents and children, there will be widespread fraud under this head and much revenue will be needlessly lost. Though it is true that dependents do decrease the tax-payer's ability, allowances for dependents are out of the question; because it will be impossible to check the number of dependents accurately without very great inquisitorial proceedings, and even that will not prevent fraudulent tax-payers cheating the state of its revenue.[1] Even as regards children, the register of births cannot be entirely relied upon.[2]

[1] Cf. the evidence of three Commissioners of Income-Tax before the Taxation Enquiry Committee.

Mr. Gimson, Commissioner of Income-Tax Assam, said, "It is not practicable without proceedings of an inquisitorial nature to make allowance for the number of persons supported out of particular incomes; but allowances for a wife (or even wives) and children might be made," p. 383, Vol.V. T. E.

Khan Wali Mohammad Sahib, Commissioner of Income-Tax, C. P. said, "I do not think that it is practicable, without proceedings of a very inquisitorial nature, to make allowance for the number of persons supported out of the particular incomes in India". P. 228, Vol. IV, T. E.

Mr. Middleton, Commissioner of Income-Tax, Bihar and Orissa, said, "I regard it as quite impracticable to make provision for allowance for the number of persons supported out of a particular income". p. 183, Vol. V, T. E.

[2] In reply to Prof. Buch's assertion that the Municipalities of Bombay and Karachi kept a perfect system of birth registration, Dr. Paranjpye retorted that the birth register in Poona was not worth the paper it was written on. p. 283—Vol. VI, T. E.

It is, therefore, proposed to limit the allowance only to children below 21 who are attending either schools or colleges. The heads of these institutions should be asked to issue certificates of such attendance to the parents who can thereupon claim relief, and it will be easy for the income-tax officer to verify these returns.[1] This is the only way in which, for the time being at least, children allowances can be efficiently administered in India without involving frauds upon the revenue.

Having thus established the case for children allowances in India, we have to determine the amount allowed in respect of each child and the limit of income to which the allowance might be granted. Considering the fact that in the foreign countries mentioned in this chapter, the allowance for children varies from 1/10 of the taxable minimum in the United States to 1/6 of such minimum in New Zealand, while it is 1/8 in England, we may fix the proposed allowance per child in India at 1/8 of the Indian taxable minimum. In other words, the allowance for each child should be a deduction of Rs. 250 from the parent's assessable income.

As regards the question of a limit, it should be remembered that the special expenditure on children progressively diminishes in importance with increase in income. A limit should be therefore fixed beyond which allowances for children should not be granted. This limit may well be placed at Rs. 10,000 beyond which the special additional expenditure will be of comparatively little importance.

To sum up, (1) The present exemption limit should be left unaltered at Rs. 2000, no separate marriage allowances being granted to the assessees ; (2) Allowances for

[1] It can be made a penal offence for the head of an educational institution to issue false certificates.

children should be made in the form of a deduction of Rs. 250 from the assessable income for every child up to a maximum number of six. This relief should be restricted to incomes below Rs. 10,000 and its financial cost is estimated at Rs. 22 lakhs.

CHAPTER IX

DIFFERENTIATION AND GRADUATION

Differentiation in favour of earned income, and graduation with increasing income—these are two consequences of great practical import which follow from the doctrine of 'ability to pay'. Differentiation is a recognition of the difference in ability between earned and unearned incomes; while graduation is a recognition of the progressive increase of ability which accompanies increasing income. In this chapter, we shall examine the extent to which these elements exist in the Indian system and consider how far they need any change or modification.

DIFFERENTIATION

By 'earned income' is meant income from personal exertion which generally means salaries, pensions, professional emoluments and other earnings of a similar nature; 'unearned income' means earnings from capital, and is generally defined as all 'income other than earned'.[1]

The Indian Income-tax is, as we have seen elsewhere,

[1] Thus in Australia income from personal exertion is defined as meaning "income derived from sources in Australia consisting of earnings, salary, wages, commission, bonus, pensions, superannuation allowances, retiring allowances and gratuities not paid in a lump sum, allowances received in the capacity of employee and the proceeds of any business (business including any profession, trade, employment vocation or calling) carried on by the tax-payer either alone or as a partner with any other person and any income from any property where the income forms part of the emoluments of any office or employment of profit held by the individual but does not include interest unless the tax-payer's principal business consists of the lending of money and does not include rents and dividends". Income from property is defined as meaning "All income derived from sources in Australia and not derived from personal exertion". Income-Taxes in the British Dominions—H. M. S. O.—pp. 243-44.

particularly distinguished by the total absence of any allowances for differentiation.[1] In this respect, foreign practice is entirely different from that of the Indian system.

Differentiation in other countries :—Most of the countries levying income-tax recognize the differences in ability between 'earned' and 'unearned' incomes ; and they make allowance for it by reducing the income-tax payable on earned income as compared with unearned income. The practice of differentiation is very popular on the continent of Europe.[2] In the British Empire, with the exception of Canada and South Africa, the rest of the Dominions (Australia, New Zealand, Irish Free State) including Great Britain allow deductions for 'earned' income ;[3] while among the Asiatic nations, Japan has introduced allowances in favour of earned income in her income-tax system.[4] We shall give below brief notes on the methods adopted and the extent of relief allowed to earned incomes in these different countries.

Great Britain :—In Great Britain, the tax-payer is allowed to deduct one-sixth of his earned income for purposes of his income-tax assessment, the maximum amount thus allowed being not more than £250.[5] This means that persons with incomes below £1,500 will derive full benefit from this allowance, their taxable income being reduced by one-sixth of its amount ; tax-payers with earned incomes above £1,500 will have only a fixed deduction of £250. The method employed for differentiation is a deduction from the assessable income in the case of earned income.

Irish Free State :—In Ireland, the allowance is given in a similar manner, but the amount allowed is only one-

[1] Vide Chapter III.

[2] Vide "Graduated Income-Taxes in Foreign States."

[3] Vide "Income-Taxes in British Dominions". Ibid.

[4] Vide 26th Financial and Economic Annual of Japan.

[5] Vide 70th Report of the British Board of Inland Revenue.

tenth of the earned income and the maximum figure thus deductible is £200. The British system is thus more liberal to tax-payers with smaller earned incomes.

New Zealand :—The allowance is given in a different form, the tax-payer being allowed to deduct 10 per cent. of so much of the tax as is levied on earned income. This deduction, however, is available only up to the maximum of £2,000 of such incomes ; so that persons with earned incomes above £2,000 will have the benefit of deduction only on the first £2,000 of their income. This corresponds to the Irish method of limiting the amount for which the allowance is to be claimed.

Australia :—In Australia the principle of differentiation is carried out in a more logical manner. The rates of the tax are different for earned and unearned incomes, unearned incomes of course paying at a higher rate, till a certain maximum limit is reached, when the rates become equal. This maximum limit was £7,600 in 1927.

Japan :—The allowances in favour of earned incomes are given in the form of a deduction from assessable income, and are restricted to incomes below 12,000 yen i. e. £1,228. Where the total income is less than 6,000 yen (£664), the individual is permitted to deduct 2/10ths of the income earned by personal service ; where the total income is less than 12,000 yen, provided that the unearned portion exceeds 6,000 yen, the amount deductible is only 1/10 of the earned income ; where however, the unearned income is less than 6,000 yen, the individual is allowed to deduct 2/10ths of that part of the earned income which if added to the unearned income would amount to 6,000 yen, and 1/10th of the remaining earned income. Thus, if the income is 10,000 yen, 4,000 of which is unearned, he is allowed to deduct 2/10ths of 2,000 yen (the excess of 6,000 yen over his unearned income) and 1/10th of the remaining 4,000, his total allowance will thus be 400 plus 400 i. e. 800 yen.

Italy:—Incomes are classified under the following five schedules[1]:—

A. Unearned income from capital.

B. Unearned and earned incomes mixed (i. e. from industry and commerce).

C.[1] Variable earned incomes (i. e. from professions).

C.[2] Fixed earned incomes (e. g. salaries, pensions, allowances, life annuities).

D. Earned incomes (i. e. state, provincial and Municipal salaries, pensions and allowances).

There is one standard rate of tax, but it is charged on different percentages of incomes according to the class to which they belong.[2] The standard rate being 20 per cent. as from January 1929, the rates on the different schedules of income works out as follows :—

Schedule			Rate
A	...	...	20 per cent.
B	...	...	14 ,,
C^1	...	...	12 ,,
C^2	...	...	10 ,,
D	...	...	8 ,,

The Italian system is therefore to keep one standard rate of tax, but vary the percentage of income liable to the tax according as it is earned or unearned.

Austria, Bavaria and Hungary:—In all these countries, differentiation between earned and unearned incomes is achieved by a scheme of supplementary taxes on sources of unearned income, in addition to the general income-tax. Such taxes are

1. Land tax.
2. House tax.

[1] Vide A. Bernard's "Taxation of Incomes, Corporations and Inheritances in Canada, Great Britain, France, Italy, Belgium, and Spain". Senate Document 186, 68th Congress, 2nd Session—pp. 131-32.

[2] Vide Manchester Guardian Reconstruction Number, 1922.

3. Business tax.
4. Dividend tax.

Salaries and pensions paid only the general income-tax and were thus more favourably treated.

Prussia, Norway and Denmark :—In Prussia, side by side with a general income-tax, there was a supplementary tax on capital value applying to property movable and immovable, except articles of personal or domestic use. The rate was flat. A similar system prevailed in the other German States. Norway and Denmark had also supplementary taxes, but the tax was graduated in the case of the latter country. The effect of this system was to exact a greater net contribution of tax from unearned income.

Sweden :—A novel method to bring about differentiation was adopted in Sweden. Where the tax-payer had property, 1/60th of the value of his property was added to his income in order to arrive at his assessable income, his unearned income thus paying at a higher rate.

Conclusion :—It is clear, therefore, that differentiation is widely prevalent in many foreign countries, the important exceptions being Canada and South Africa. The methods employed to secure differentiation are mainly three :—

1. Deduction from income :—The tax-payer is allowed to deduct from his earned income a fixed proportion before being assessed to the tax (Great Britain, Irish Free State, Japan). A maximum limit is generally prescribed beyond which this relief to earned incomes is not allowed (Irish Free State, Japan).

2. Different Rates of Tax :—This method, by which there are different rates of tax for earned and unearned income, is found in Australia, New Zealand and in effect in Italy also.

3. Property taxes in addition to Income-tax :—There are two variations of this method. One is to have a

separate tax on the capital value of property in addition to the income-tax (German states, Prussia, Norway and Denmark) ; the other is to have in addition to the income-tax separate taxes on the different property-incomes (Austria, Hungary and Bavaria).

THE INDIAN POSITION

Need for Differentiation :—The Indian position, as we have already pointed out, makes no allowance for differentiation ; both earned and unearned incomes being treated in an exactly similar way by the Indian income-tax. Considering the long period for which the Indian tax has existed in our country it is strange that such an obvious reform has not yet been introduced. It is high time that this defect of the Indian tax should be rectified by the introduction of differentiation.

Form of Differentiation :—The first thing to be determined in any scheme for the introduction of differentiation is the form it should take : whether earned incomes should be taxed at a lower rate or whether unearned incomes should be made to pay at a higher rate. In this connection, we must remember that we have already recommended the introduction of children allowance. Besides, as we shall see in the following section, the present rates of the tax are not sufficiently high for certain levels of income and we have therefore proposed some increase in the rates for certain grades of income.

Under these circumstances, it is desirable that differentiation should take the form of a higher levy on unearned income. Looking to the fact that in England unearned incomes pay at a rate about 18 per cent. higher than earned incomes, we might fix the additional charge on the Indian unearned incomes at 10 per cent. of the tax levied from equal amounts of earned income. Thus, if a certain amount of earned income pays 10 per cent., an equal

amount of unearned income should pay 11 per cent. by way of income-tax.

Should Differentiation be restricted to incomes below a certain level? :—The second point to be considered is whether this higher taxation by way of differentiation should be limited to unearned incomes below a certain amount. Foreign practice favours the limitation of differentiation ; but its theoretical grounds are not so clear. An earned income remains an earned income whatever be its amount ; similarly an unearned income cannot change its nature because it is greater in amount. Besides, the limitation of differentiation to incomes below a certain level will defeat the very object of differentiation, as a considerable portion of the Indian unearned incomes belong to persons with large estates. The higher rate should therefore apply to all unearned incomes irrespective of amount.

Is Corporate income unearned? :—The third thing to be considered is the meaning that is to be attached to unearned income. So far as income from securities, landed property and agricultural rents are concerned, they are undoubtedly derived from capital and form unearned income ; similarly income from salaries, pensions and professional emoluments are clearly the result of labour and do not form unearned income. The real difficulty is with regard to income from companies. In a sense, it is unearned looking to the fact of limited liability and the passive part taken by the shareholders in earning that income ; in another sense, it is earned as there is a great risk of loss of capital. From a strictly theoretical point of view, this should be treated as a mixed income. But, considering the general desirability of encouraging the joint-stock company movement in India, we may treat corporate income as "Earned" for purposes of the Indian Income-Tax.

A Scheme of Differentiation :—Our scheme can thus be summed up—unearned incomes should pay in addition

to the tax ordinarily payable by them 10 per cent. more of such amount, so that under our scheme an unearned income of Rs. 20,000 will pay the amount payable by an earned income of Rs. 20,000 plus 10 per cent. of such amount. Thus, if the amount of income-tax payable by an earned income of Rs. 20,000 comes to Rs. 2,000, then the income-tax payable by an unearned income of equal amount namely Rs. 20,000 will amount to Rs. 2,000 plus Rs. 200 equal to Rs. 2,200. This higher rate should not be restricted to incomes below any particular level, but should apply to all unearned incomes irrespective of their amount; corporate income should not be treated as unearned.

Before passing on to discuss the progression of the tax we must consider certain objections that are usually levelled against any scheme for the introduction of differentiation in the Indian system. The objections are (1) that it would discourage capital investment.[1] (2) that it is not financially worth while, there being little unearned income in India.[2] (3) that it would needlessly complicate the administrative machinery and prove unworkable in practice.[3]

(1) *Differentiation as Discouragement to Capital*:—We are told that India is an industrially ill-developed country and in great need of capital. Differentiation will involve

[1] Vide evidence of Mr. S. S. Iyer, Lecturer in Economics, Madras, T. E. Vol. III, p. 83.

[2] Cf. "Mr. Gaskell (Commissioner of Income-Tax, U. P.) "I do not think that so far as the U. P. are concerned, it would be of any advantage trying to distinguish between earned and unearned incomes. The unearned would be a very small proportion especially when that is the sole income", T. E. Vol. III, p. 55. Also of Mr. Middleton (Commissioner of Income-tax, Bihar and Orissa) "The Indians are apparently not by nature investors and instances of a man investing his savings or inherited wealth and living on the interest are very rare". Vol. V, p. 183.

[3] Vide Mr. Gimson (Commissioner of Income-Tax, Assam) "Further experience in the working of the income-tax seems to me to be necessary before such refinements are introduced into the country." T. E. Vol. V, p. 383.

a higher rate of tax on income from capital, which means that incomes from capital are put at a discount as contrasted with other incomes. This will result in a great discouragement to capital investment; it might prevent the industrial development of the country, retard the growth of its wealth, and thus reduce its per capita income. If this argument were correct, there is no doubt that however justified differentiation might be on theoretical grounds, it could not be advocated in practice. But it is not true. The unearned incomes we are proposing to tax at a higher rate include only incomes from securities, landed property and agricultural rents. They do not include income from companies, and consequently joint-stock enterprise will not be discouraged. There is no need, therefore, to fear that the industrial development of the country will be adversely affected by differentiation. As regards securities, the safety of capital afforded by investment in Government and Municipal securities is sufficiently great to off-set the disadvantage of the higher tax payable by them. As regards income from house property, great harm will not result even if differentiation results in discouragement of investment in property.[1] As it is, land is not very productive in India and there is a false social prestige attaching to its possession which creates an artificial hunger for land. The savings of the middle classes are more urgently required for industrial development. In view of all these factors, we need not take this objection seriously.

(2) *Differentiation as yielding little additional revenue* :—It has been asserted that there is little unearned income in India and any proposal to tax it will result in a very small amount of revenue. It may be pointed out that advocates of differentiation base their claims on its con-

[1] Cf. Mr. Bhatnagar "It is desirable to encourage the investment of capital in industry and trade rather than in landed property". T. E. Vol. IV, p. 358.

formity to the doctrine of ability to pay. The amount of revenue raised by the taxation of unearned income is not a very material factor in considering the introduction of differentiation. Even assuming that financial considerations do matter, there is a sufficient amount of unearned income in India which will be taxed under our scheme. Out of the 225 crores of Indian taxable income, in 1926-27 about 24 crores were derived from securities and property.[1] If we add to this, 15 crores of permanent zemindary income which will be taxable under our scheme,[2] and also assume an income of Rs. 2 crores from the landlords of Central Provinces, there will be roughly 40 crores of unearned income in India. This is not a small amount to justify the objection referred to above.

(3) *Administrative Considerations*:—Another objection frequently raised is that differentiation will prove unworkable in practice. Our scheme for the introduction of differentiation, however, makes due allowance for this factor by not recommending the system of deductions from assessable income, which might have greatly increased the work of giving refunds. Our scheme is based on lines similar to that of New Zealand and Australia ; instead of deducting a part of the tax payable by earned income, we have recommended that the tax payable from unearned incomes be uniformly increased by 10 per cent. At the same time, it will not be difficult to realise this higher rate in practice ; because, even as it is, our income-tax

[1] The figure of income from securities is taken from Return III A. No figures are given of income from property. Figures of tax collected from property are available (Return A). Even these cannot yield an accurate result of the taxable income, as no figure of the distribution of property by income grades is available. The highest rate of income-tax is 18 pies and the lowest rate 5 pies in the rupee. If we assume that on an average the rate works out at 9 pies per rupee, property income may be roughly expected to reach Rs. 14.64 crores. Adding to it 9.10 crores of income from securities, we get an unearned income of Rs. 23.74 crores or nearly 24 crores.

[2] Vide chapter VI in which we have recommended the taxation of agricultural income from permanently settled estate.

system divides incomes into schedules which are more or less based on the fact of income being earned or unearned. For example, schedules 2 and 3 relate to incomes from securities and landed property; and rents from agricultural lands might be classed under a separate schedule. As we are going to propose that the super-tax should begin at Rs. 30,000 instead of at Rs. 50,000 as at present, the higher rates on unearned income can be deducted at source for incomes below Rs. 30,000; as for incomes above that amount, the tax can be realised direct from the assessee.

Thus under our system, income-tax will be levied under 7 schedules, 4 consisting of earned income, and 3 of unearned income.[1] This will effectively meet the administrative difficulties attendant on the working of the principle of differentiation.

Conclusion:—We have examined the objections against the taxation of unearned incomes at a higher rate, and we have seen that in spite of these objections our scheme is desirable as well as practicable. It is difficult to estimate the exact yield from this higher taxation of unearned incomes, because no statistics are available regarding the distribution of incomes from landed property. Looking, however, to the fact that the income from securities and agricultural rents is concentrated in the hands of persons with incomes of more than Rs. 50,000,[2] and also considering that the highest effective rate of income and super-tax is to-day about 30 per cent. we may say that, on an average, these incomes will yield a net addition

[1] The 'earned income' schedules will be salaries, business income, professional earnings and other sources. The 'unearned' income schedules will be, securities, property and agricultural rents.

[2] Out of the 73 lakhs of tax realised from securities only, 6 lakhs were refunded as belonging to persons with income below Rs. 50,000; a good deal of the security income is therefore concentrated in the hands of persons with large incomes. As regards income from agricultural rents, we already pointed out in Chapter VI that a small number of zemindars hold a large amount of income.

of 1.5 per cent. of what they are yielding to-day.[1] This will amount to Rs. 60 lakhs, a not inconsiderable figure. Apart from this increase in revenue, the proposed reform will place our tax on a more equitable basis, and also bring it into line with the progressive income-tax systems of the world.

GRADUATION

In chapter III, we have already given the schedule of rates of the present income and super-taxes. The super-tax is really an additional levy of income-tax and need not be separately considered, except so far as the form of its graduation is concerned. In discussing the rates of the tax with reference to the amounts of income, we shall first examine the form of graduation, then analyse the rates of the tax with reference to general principles of progression, as well as the practice abroad, and finally suggest changes, if any.

THE FORM OF GRADUATION

The Present position described and examined :—The income-tax proper is levied by way of six rates, beginning with five pies in the rupee on an income of Rs. 2,000 and reaching the maximum of eighteen pies in the rupee on an income of Rs. 40,000 and over.[2] These rates however

[1] If all persons owning unearned income were liable at the highest rate, the additional tax realisable from differentiation will be 10 per cent. of what they are ordinarily paying to-day, or 3 per cent. of their income. Every owner of unearned income, however, will not be liable at the highest rate, though a number of zemindars will be liable. We may therefore roughly assume that, on an average, unearned incomes will be liable at half the highest effective rate, in which case the additional tax would be 1.5 per cent. of their income instead of 3 per cent. And 60 lakhs is 1.5 per cent. of 40 crores.

[2]

Amount of Income.	Rate in the Re.
2,000	5 pies
5,000	6 ,,
10,000	9 ,,
15,000	10 ,,
20,000	12 ,,
30,000	15 ,,
40,000	18 ,,

are not levied on the successive doses of income; each rate is applicable to the entire income of the person who comes under its category, e. g. if an individual gets an income of Rs. 22,000 he will pay 12 pies in the rupee, not merely on the excess of his income over Rs. 20,000, but on every rupee of his income. These involve what are known as 'Jumps' in the graduation, the effective rates of the tax rising very sharply without a corresponding rise in the amount of the income. The whole situation is clearly revealed by graph I.

These 'jumps' undoubtedly interfere with the fair progression of the tax; as for example, in the illustration given above, the individual whose income is Rs. 22,000 pays on his entire income at 12 pies in the rupee, while the one with Rs. 19,999 pays only at the rate of 9 pies. It is difficult to accept the inference that, by an increase of only Rs. 200, the individual gets a higher taxable capacity of 3 pies in the rupee on his entire income. Indeed the position was such that owing to these sudden jumps, the individual with the higher income was, after payment of the tax, actually in a worse position than the one with the lower amount of income. Thus an individual with an income of Rs. 10,000 had to pay Rs. 469 while an individual with an income of Rs. 9,999 paid only Rs. 312. So that after payment of tax their net incomes were as under :—

Before payment of tax		After payment of tax
Rs.		Rs.
10,000	less 469	9531
9,999	less 312	9687

This glaring anomaly was removed by the adoption of the following device. Section 17 of the Indian Income-Tax Act provided that where, by reason of his total income reaching or exceeding a certain limit, the assessee becomes either liable to the tax or liable to pay it at a

higher rate, the total tax payable by him shall not exceed the aggregate of the following amounts, namely,

(a) the amount which would have been payable, if his total income had been a sum of one rupee less than that limit,

(b) the amount by which his total income exceeds that sum.

In view of this, in the instance referred to above, the tax actually payable by the person whose income is Rs. 10,000 will not be Rs. 469 but it will be Rs. 313 only. (The amount payable by the person whose income is Rs. 9,999 plus one rupee which is the excess of his income over that of the one whose income is Rs. 9,999.) Thus, the assessee with the higher income is saved from being in a position that is worse than that of the one with the lower income.

"Jumps" and the Indian Graduation:—The device, however, cannot solve the problem of 'Jumps'; it only meets the case of those who are immediately above the grade where the increase in rates takes place, namely, persons with incomes just above Rs. 5000, 10,000, 20,000, and so on. But these persons form only a small fraction of those that are similarly affected. As can be seen from Graph I, the jump is still there as strongly as before, and all persons with intermediate incomes between these steps are vitally affected, e. g. the individual whose income is 10,163 pays at the rate of 9 pies while the individual with 9,999 pays at the rate of 6 pies in the rupee. Such sharp differences in the amounts paid cannot be traced to similar sharp differences in the amounts of income, which is the real determining factor of 'ability'. As a matter of fact, such payments definitely conflict with the individual's ability to pay, and cannot be justified on strict theoretical grounds. This is, therefore, a fundamental defect.

The value of the doctrine of ability lies in regulating the

individual's payments in accordance to his 'ability'; and the predominant factor in this 'ability' is the amount of his income. As we have explained elsewhere, the rates of the tax rise with the increase of income, because the marginal utility of the last rupee of income decreases with the increase of income. Strictly speaking, therefore, a theoretically perfect income-tax will contain a schedule of rates that will rise on the successive units of the individual's income. This however is too laborious and complicated a process to be successful in practice, but the rates should be so fixed as to result, as far as possible, in a smooth curve of progression. In any case, 'Jumps' are absolutely inconsistent with this criterion.

Forms of Graduation adopted abroad:—There are three ways in which 'jumps' in graduation can be reduced, smoothened or avoided: (1) the first method is to have a formula which will increase the rate of the tax with the rise of every unit of the tax-payer's income. This method is followed in Australia, New Zealand and South Africa.[1] (2) The second method is to make the categories as large in number as possible, so that the jumps will be negligible in amount and spread over many categories. This method used to exist in the pre-War German states, Austria and Hungary; also in Sweden where there was a schedule of 1,146 grades. (3) The third method is to allow a general abatement from income, while taxing the excess at an unvarying rate. This method is found in Great Britain which allows a fixed abatement of £225 for married tax-payers.

A Solution of the Indian Problem:—Of these three methods, the third appears to be the most suitable to

[1] In South Africa, persons other than companies are taxed at one shilling in the £, increased by 1/1200th of 1d for every £ in the taxable amount, subject to a maximum rate of 2s in the £. Thus, an individual with £600 will pay on £200 (he is allowed £400 as a personal allowance) at the rate of 1 sh plus 200/1200 d = 1 sh 1/6 d. The rate thus goes on steadily increasing with increasing income, till the maximum of 2 sh in the £ is reached on an income of £24,000.

Indian conditions. This is because the first method involves formulae which are not likely to be understood by ordinary people. With regard to the second method, it is only a via media, and instead of removing 'jumps', introduces a complicated system of a large number of grades. The third is simple to understand; at the same time it results in a fairly smooth curve of progression. We therefore propose that Rs. 2,000 should be allowed as a personal abatement for all incomes subjected to income-tax; and instead of the present six rates, there should be substituted one standard uniform rate. To remove regression in the lower incomes, it may be provided that the tax will be levied only at half the standard rate on the first fifteen thousand rupees of the tax-payer's income. In fixing the standard rate, we must consider what will be the resulting effective rates for incomes below Rs. 50,000. Indian rates for incomes between Rs. 10,000 and Rs. 50,000 are lower than the corresponding rates in the United Kingdom and Japan; but the Indian rates are higher than similar rates in Canada, South Africa and the United States. The practice of the latter countries cannot be made an excuse for continuing the Indian rates at their present low level. The weight of evidence both official and non-official—given before the Taxation Enquiry Committee was in favour of an increase in the rates of the tax for incomes below Rs. 50,000. [1] Details of these proposals are given in Appendix VI. The Taxation Enquiry Committee recommended the introduction of intermediate rates of 9 pies in the rupee for incomes between Rs. 20,000 and 25,000. [2] Besides, the weight of indirect taxation on people with incomes above Rs. 10,000 is not very appreciable. The standard rate must therefore be such as will result in an increase of the

[1] Vide T. E. C. Report, p. 200.

[2] Mr. W. T. Layton, has made a similar recommendation. Vide Vol. II, Simon Commission's Report.

existing effective rates in addition to smoothening the graduation. This result is obtained if we fix the standard rate at 2 annas in the rupee.

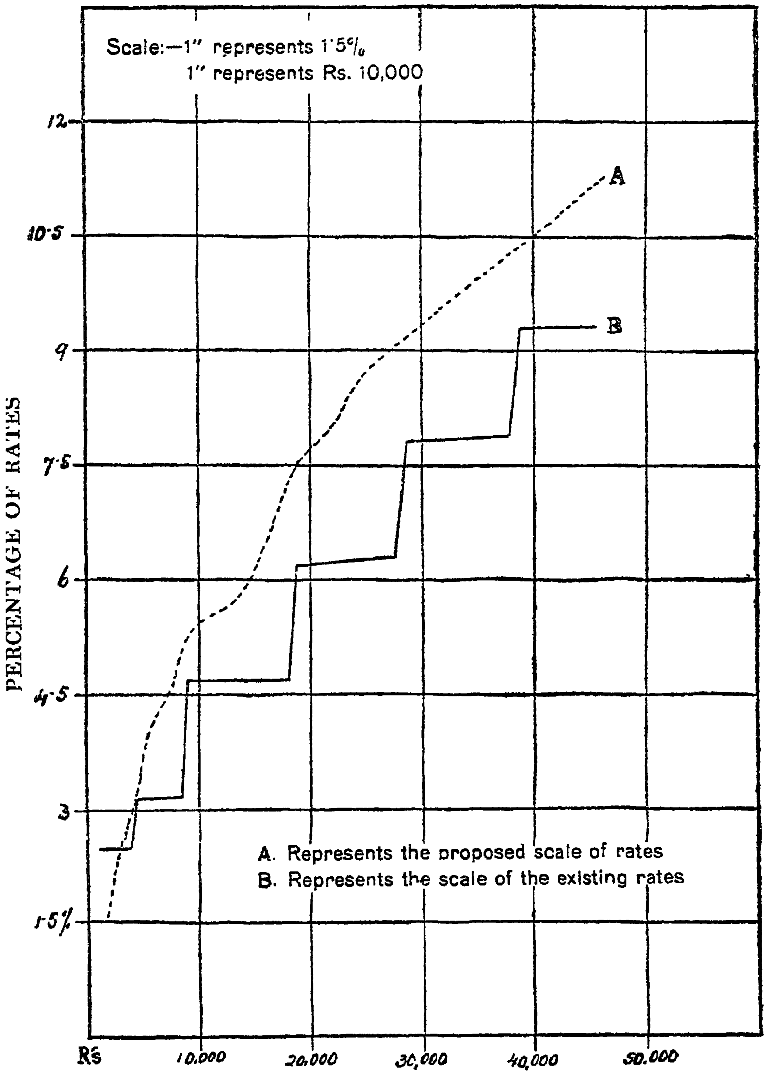
The following table sets forth in brief the effective rates of the income-tax—as they are existing to-day and as they will be under our scheme.

Amount of income	Effective percentage of income taken by way of taxation or effective rate of tax	
	Present rate	Proposed rate
2,052[1]	2·58	nil
4,000	2·58	3·12
6,000	3·12	4·17
8,000	3·12	4·70
10,000	4·68	5·00
12,000	4·68	5·20
14,000	4·68	5·36
15,000	4·68	5·42
17,000	4·68	6·25
19,000	6·25	6·91
21,000	6·25	7·44
23,000	6·25	7·73
25,000	6·25	8·23
27,000	6·25	8·56
29,000	6·25	8·84
30,000	6·30	8·96

Attention is drawn to Graph I which illustrates the effective present and proposed income-taxes. The adoption of our method removes the obnoxious 'jumps', and also results in making the rates of tax more suited to the individual's ability to pay.

[1] The present income-tax effectively begins at 5 pies in the rupee only on income of and exceeding Rs. 2052. This is due to Sec. 17 of the Indian Act which tries to meet the problem of 'jumps' which has already been described above.

GRAPH NO. I. SHOWING THE EFFECTIVE RATES OF TAX PAYABLE ON INCOMES BETWEEN RS. 2000/- AND RS. 50,000/- UNDER THE EXISTING AND PROPOSED SCHEMES



The problem of 'jumps' does not arise in relation to the super-tax as its graduated rates are levied on successive slices or doses of income. As regards the existing progression of the super-tax, we shall deal with it below when discussing the progression of the income-tax.

PROGRESSION OF THE TAX

It is not possible to fix any formula of rates which might be supposed to fulfil the theory of progression. This was amply proved by several expert witnesses—prominent among whom was Professor Pigou—before the British Royal Commission on Income-Tax. The only factors, then, which should guide us in fixing the rates of the tax, are the incidence of indirect taxation, the practice abroad, and finally what appears to be a 'reasonable' progression.

As regards the incidence of indirect taxation, no definite conclusions are possible owing to the poverty of material which has already been pointed out. However, we may generally say that the amount paid by way of indirect taxation bears a steadily decreasing proportion to the tax-payer's total income. The chief items paid by the richer classes are customs duties on luxury articles such as motor cars, watches etc. ; the effect of even this grows inconspicuous after a high level, say, a hundred thousand rupees, is reached. We must not, therefore, look to indirect taxation to redress any inequality in the existing incidence of the Indian tax system. The rates of income-tax must go on increasing with increasing income. Of course, the increase cannot be without limit ; even from a strictly theoretical point of view, ability stops rising rapidly after a high limit of income is reached, while in practice, it is impossible to tax incomes at an indefinitely increasing rate.

It has not been found possible to compare the Indian rates with the income-tax rates of many countries, but we

shall discuss the Indian rates as compared with the rates of some foreign countries, namely, Canada, South Africa, Great Britain, United States of America and Japan. The detailed table of rates comparing the Indian rates with the rates of these countries have been calculated generally for the year 1926,[1] the conversion into rupee being made at par rates of exchange. These detailed figures are given in Appendix VII. We shall now add short notes on the Indian curve of progression as compared with that of other countries. Attention is invited to graph II, which illustrates the courses of the progression underlying these different income-taxes.

India and the United Kingdom:—The Indian taxable minimum is lower than the English one. Excepting this, the rates of the British income-tax are uniformly higher especially for incomes below Rs. 50,000 and for incomes above Rs. two lakhs. The highest rate is more than 43.75 per cent., which, however, is the last point plotted on the graph.

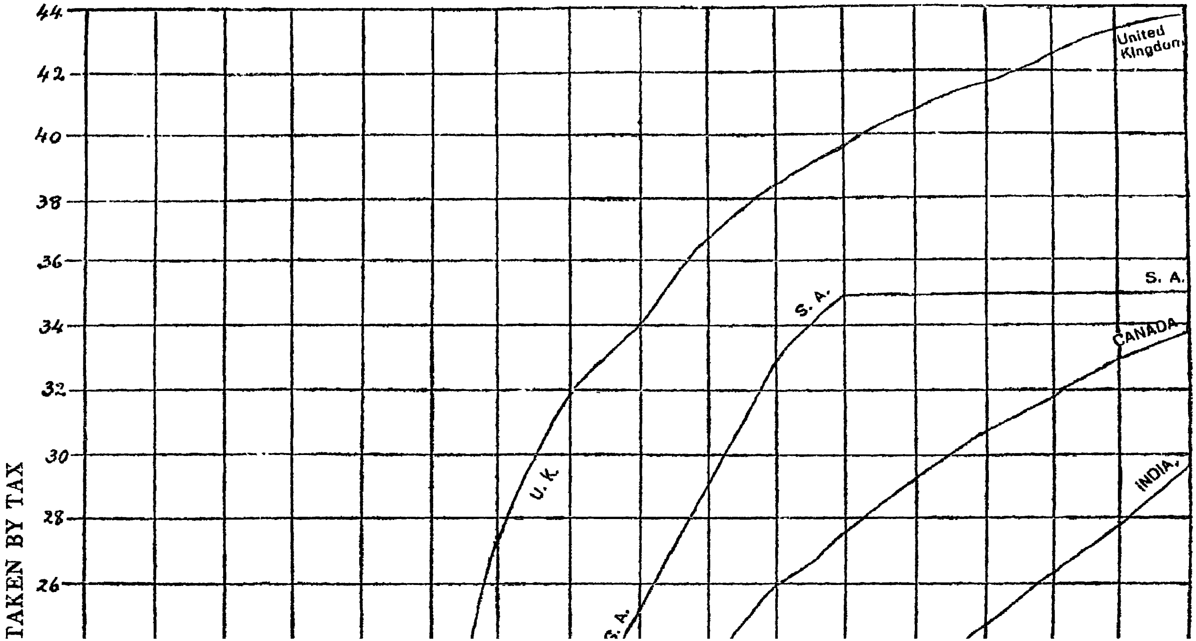
India and the United States of America:—In direct contrast to the United Kingdom, the rates of the United States of America are uniformly lower than those of India. The difference is especially sharp for incomes below Rs. 50,000 and for those above Rs. 3,50,000. It must be remembered that this scale of low rates in America is due, first, to her great economic prosperity which makes the tax very productive, and second, to the existence of concomitant state income-taxes which take away a portion of the individual's income. The American taxable minimum is also much higher than the Indian.

India and Canada:—The taxable minimum in the Dominion of Canada is, as in the United States of America, much higher than the Indian minimum. The rates of the tax are uniformly lower for incomes below Rs.

[1] The rates of the Canadian and Japanese income-taxes relate to the year 1925-26.

GRAPH NO. II.

GRAPH ILLUSTRATING THE EFFECTIVE PERCENTAGES OF INCOME TAKEN BY THE INCOME TAXES OF THE UNITED KINGDOM, JAPAN, SOUTH AFRICA, CANADA, THE UNITED STATES OF AMERICA AND BRITISH INDIA



50,000, but display a sharp graduation above that limit, especially for incomes above Rs. 1,50,000. Her highest rate is 41.83 per cent. as contrasted with the Indian 29.43 per cent.

India and South Africa :—Like Canada, South Africa has also a higher taxable minimum than India, and with the exception of incomes between Rs. 10,000 and 20,000, her rates are uniformly lower than Indian rates for incomes below Rs. 50,000. Thereafter, the rates rise very sharply, especially for incomes above 1,50,000. The highest rate is 34.91 per cent. as contrasted with India's 29.43 per cent.

India and Japan :—The taxable minimum in Japan is not lower than that in India. The Japanese rates of the tax show uniform increases over the Indian rates till the level of Rs. 4,00,000 is reached. This increase is very perceptible for incomes between Rs. 2000 and Rs. 50,000. The Japanese rates rise again for incomes above Rs. 13,50,000, and finally reach the highest rate of 36 per cent. as contrasted with the Indian rate 29.43 per cent.

Conclusion :—We give below our conclusions on the progression of the Indian income-tax as compared with that of all other countries :—

1. With the exception of Japan, the income-tax is levied on much lower incomes in India than elsewhere.

2. With the exception of Great Britain and Japan, the rates of the tax for incomes below Rs. 50,000 are slightly higher in India. In South Africa, however, the rates are higher for incomes below Rs. 25,000.

3. With the exception of the United States of America, Indian rates are uniformly lower than the rates in other countries on incomes exceeding Rs. 50,000.

4. With the exception of the United States of America the highest rate in India is much lower than that in other countries.

We have already observed that the United States of America cannot be compared with India, owing to the existence of additional State income-taxes in the United States. Besides, if inheritance taxation can be regarded as a sort of deferred income-tax, and it is so regarded by many, the effective rates of income-tax in other countries will be much higher than even those shown in our graph.

A PROPOSED SCHEME OF PROGRESSION FOR THE INDIAN INCOME-TAX

Taking all this into consideration and looking to the generality of foreign practice, we may formulate the following income-tax and super-tax rates to replace the existing schedule :—

1. A fixed abatement of Rs. 2000 to be given on all amounts irrespective of income.

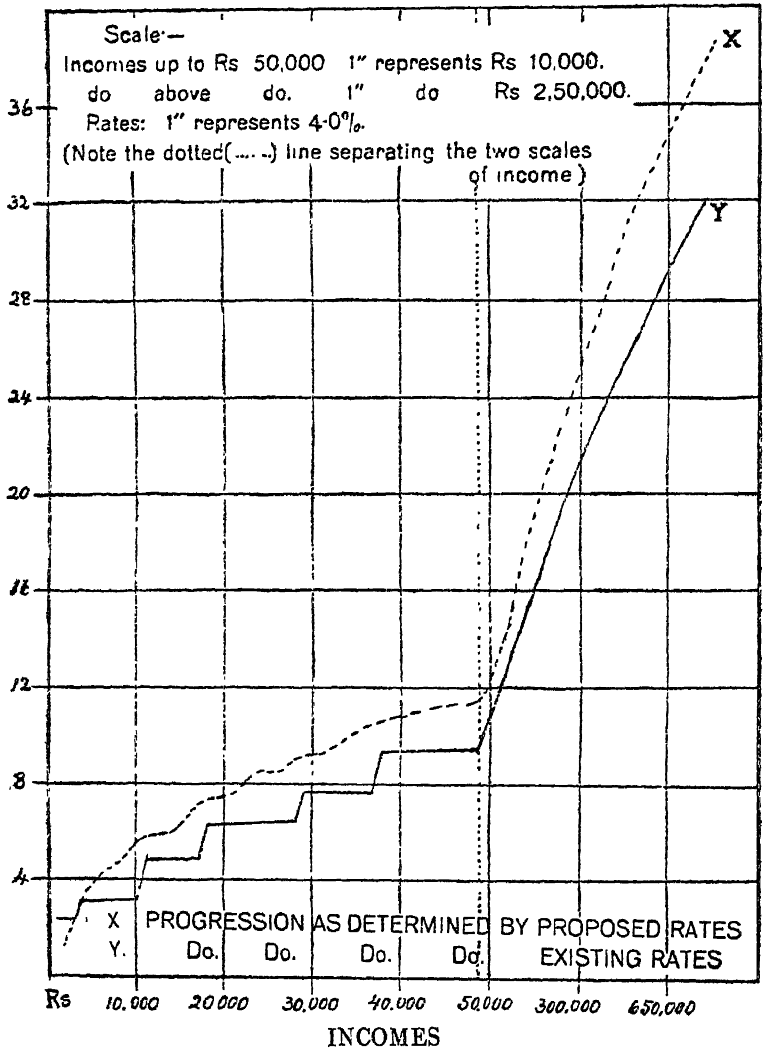
2. The standard rate of income-tax be fixed at 2 annas in the rupee ; on the first 15,000 of the individual's income, however, the tax should be levied at half the standard rate.

3. The super-tax to begin on incomes exceeding Rs. 30,000 and the following to be the schedule of rates in the rupee :—

On the first excess of Rs. 10,000 over the minimum 3 pies

On the next excess of Rs.		10,000	......................6 pies
,,	,,	,, 50,000	......................1 anna
,,	,,	,, 50,000	......................1 anna 6 ps.
,,	,,	,, 50,000	......................2 As.
,,	,,	,, 50,000	......................2 As. 9 ps.
,,	,,	,, 50,000	......................3 As. 6 ps.
,,	,,	,, 50,000	......................4 As. 3 ps.
,,	,,	,, 50,000	......................5 As.
,,	,,	,, 50,000	......................5 As. 9 ps.
,,	,,	,, 50,000	......................6 As. 6 ps.
,,	,,	,, 50,000	......................7 As.

GRAPH NO. III. SHOWING THE PROGRESSION OF THE INDIAN TAX UNDER THE PRESENT SCHEME OF RATES AND THE NEW SCHEDULE PROPOSED IN THIS BOOK



On the next excess of Rs. 50,000	....	7 As. 6 ps.
,, ,, ,, 50,000	....	8 As.
,, ,, ,, 50,000	and above	9 As.

The effective rates of income-tax and super-tax as they are levied to-day and as they will be under the proposed scheme are given in Appendix VIII. They are illustrated by means of graph III.

Objections :—Two possible objections may be raised against our scheme, viz., (1) that it savours of socialistic ideas of redistribution of wealth, and will be opposed by the capitalistic classes, (2) that it may prove administratively unworkable.

As regards the first objection, it should be pointed out that high rates have the strength of foreign practice behind them. Conservative and undoubtedly capitalistic countries like Great Britain and Japan tax income at much higher rates, than those proposed above. This objection therefore need not be taken seriously.

The second objection appears more plausible. In fact, on the same ground, the Taxation Enquiry Committee refused to recommend the introduction of a scheme similar to that of England. The chief point in this objection is that it will increase the work of giving refunds. It is difficult to see how this can be so; even to-day the tax is deducted at source at the maximum rate and involves giving of refunds to all people with incomes below Rs. 50,000. Under our scheme, the tax will continue to be deducted at the standard rate of income-tax (which corresponds to the present maximum rate). Our standard rate however applies to persons with incomes above Rs. 30,000 (where the super-tax begins), and therefore, the number of people claiming refunds will be actually less than those under the present position. Other incomes which are taxed directly to-day will continue to be so taxed under our scheme.

The objection that the proposed scheme will be complex and ununderstandable cannot be really justified by facts. As we propose no change in the form of graduation as regards super-tax, the objection can only apply to our scheme of fixed abatement and standard rate of income-tax. This, it is submitted, will be really more intelligible, the man in the street taking the abatement of Rs. 2000 as a sort of personal allowance for the essential expenses of maintenance. Besides, it removes the keenly felt injustice involved in 'jumps'.

SUMMARY

We have seen that there are two great defects in the existing system of income-tax in India. Firstly, there is no differentiation between earned and unearned incomes. Secondly, the existing form of graduation with its big 'jumps' is contrary to the individual's ability to pay. To remedy these two defects, we have proposed (1) that unearned incomes should pay a 10 per cent. higher tax than earned incomes. (2) Our second proposal is that the present method of six income-tax rates beginning with 5 pies in the rupee and ending with 18 pies should be abolished, and in its place a form of graduation on British lines should be introduced. Rs. 2000 should be allowed as a fixed abatement, and the standard rate of income-tax fixed at 2 as. in the rupee. On the first Rs. 15,000 of his income, however, income-tax should be levied only at half the standard rate. (3) Our third proposal is that the minimum taxable income for super-tax should be Rs. 30,000 instead of Rs. 50,000, the rates to rise more sharply than at present. The proposed highest rate on the last slice of income will be 9 annas in the rupee as contrasted with the 6 annas of to-day. The proposed scheme will involve no financial loss, and may probably result in an appreciable increase of revenue. On administrative grounds, there seems to be no serious objections.

CHAPTER X

SPECIAL CLASSES OF TAX-PAYERS

We have hitherto dealt with what may be called the *personal* aspect of the Indian Income-Tax, the preceding two chapters being mainly devoted to an analysis of its incidence on the *persons* paying it. But the tax is imposed not only on persons but also on associations of persons such as companies, firms and Hindu undivided families. These associations are treated as separate legal and taxable entities and may therefore be considered as special classes of tax-payers. Since all taxation is ultimately borne by the individual, we shall consider below how far the income-tax on these special classes is shifted, and whether the resulting incidence is in harmony with the general principle of ability to pay which governs the personal income-tax. We shall also consider other reforms which may bring the taxation of these special classes in line with the fundamental principles of taxation.

COMPANIES

THEORY AND PRACTICE OF COMPANY TAXATION[1]

Before discussing the taxation of corporate profits in India, it may not be out of place to consider in brief the foreign practice regarding such taxation, and correlate it with the trend of modern theory.

[1] The facts in this section have been drawn from the following publications :—

(1) Income-Taxes in British Dominions.
(2) The Income-Tax in Great Britain and the United States—Spaulding.
(3) Graduated Income-Taxes in Foreign States (1913).
(4) 26th Financial and Economic Annual of Japan.
(5) Taxation of Incomes, Corporations and Inheritances in Canada, Great Britain, France, Italy, Belgium and Spain, by A. Bernard.

There is no uniformity of procedure in the taxation of companies abroad, but two distinct principles can be discerned as regulating their operation. For example, there are some countries where the Company acts merely as an agent for its shareholders, collecting tax from the latter on behalf of the state ; while there are others, where the company is credited with a specific taxable capacity of its own and subjected to a separate corporation tax, though some concession is granted to the shareholder who is also subjected to the personal income-tax. We give below a brief description of company taxation in several foreign countries.

Great Britain :—In Great Britain, companies are subjected to the standard rate of income-tax. Such payment of income-tax by the company is regarded as made on behalf of the shareholder who is therefore exempted from the tax on his dividends. If the rate applicable to the shareholder's total income is less than the standard rate at which the company's profits have been taxed, he is refunded the excess tax thus collected on his dividends. The standard rate of Great Britain corresponds to the maximum rate of the Indian tax. It is clear that under the British system, companies are not endowed with any special taxable capacity, but are merely regarded as agents for collecting at source the tax due from the shareholder.[1]

South Africa :—It appears that a similar practice is followed in South Africa. Dividends and debenture interest in respect of which the company has paid the nominal tax are exempt in the hands of the shareholders and debenture holders.

The United States of America :—In the United States companies have to pay a corporation profits tax at a flat rate on their total profits. The rate is higher than the high-

[1] It may be pointed out that before 1924 companies in Great Britain were subjected to a corporation profits-tax, which corresponds to the super-tax imposed on companies in India. The corporation tax was abolished in 1924, and has not been renewed.

est normal rate of income-tax, but dividends are not taxed again in the hands of shareholders. This does not mean however that the company is regarded as an agent for the shareholder ; the shareholder, though exempt from the income-tax on his dividends, cannot claim any refund if the rate of tax applicable to his total income is lower than the rate at which the company has paid the tax. The exemption is thus only a politic concession to the shareholder, and the company is credited with a separate taxable capacity of its own.

Australia :—In Australia, the company is taxed at a flat rate. The shareholder is not taxed on his dividends unless his personal rate exceeds the company's rate of tax, in which case he has to pay the excess to the state. The position corresponds in the main to that in the United States. While shareholders may be called upon to pay the excess if their personal rate exceeds the company's rate, they cannot claim a refund if the reverse is the case. This necessarily means that it is not the shareholder's ability to pay which governs the taxation of companies, but that a separate taxable capacity on the part of companies is recognised.

Canada :—In Canada, companies are taxed on their total profits, while at the same time, shareholders are also taxed on their income from companies. Canada is thus the sole instance of a country which logically carries out the doctrine of the separate taxable capacity of companies.

Some European Countries :—A second method of such company taxation is found on the continent of Europe—especially the pre-War German states. The company was taxed only on that portion of its profits which was in excess of a prescribed percentage—generally 4 or 5 per cent. of its paid-up capital. The dividends were also liable in the hands of the shareholder. In this way, double taxation was avoided to the extent of the amount (4 or 5 per cent.) exempted from the company tax. The tax

obviously attempted to reach a peculiar taxable capacity of companies, which was measured by that part of their profits which exceeded the normal interest due to the shareholder.

A somewhat similar system is prevalent in Belgium to-day. Companies are allowed to deduct from their assessable income that portion of it—not exceeding 6 per cent. of its paid-up capital—which is liable to the personal property tax. In this way, double taxation of corporate income is avoided to the extent of 6 per cent. of the paid-up capital of companies.

Japan :—In Japan companies are not only subject to the ordinary income-tax, but to an additional special income-tax on that part of their profits which exceeds 10 per cent. of the average amount of their paid-up capital and reserves.[1]

Summary :—Our study of company taxation shows that with the exception of Great Britain and South Africa, the other countries seem to regard companies not only as separate objects of taxation, but as having a specific taxable capacity of their own. As a matter of concession, most of these countries (excepting Canada) exempt the individual from paying income-tax on his corporate income ; but he is not allowed to claim any refund if his personal rate is less than the rate paid by the company. No super-tax is levied on companies in any of these countries ; instead, the shareholders are taxed directly on their corporate income. This does not mean that shareholders can escape super-tax by allowing their corporate profits to lie undis

[1] The actual rates are :—
That portion of income in excess of 10 per cent.
and under 20 per cent. of the capital...... 4 per cent.
That portion of income in excess of 20 per cent.
and under 30 per cent. of the capital...... 10 per cent.
That portion of income in excess of 30 per cent.......20 per cent.
26th Financial and Economic Annual of Japan, p. 31.

tributed with companies. Provision is made by most of these countries by which if a reasonable share of the total profits is not distributed, the income-tax officer can tax the shareholders on these undistributed profits as if they had been distributed to them in proportion to their holding of shares.[1] We shall now consider whether the practice referred to above is theoretically justifiable.

It is claimed that companies are separate legal entities, that they enjoy certain unique privileges, and it is therefore proper that they should pay higher taxation. The answer largely depends on the nature of the tax levied on a company. If it is levied on its paid-up capital[2] or its total turnover or on any such index of corporate life, the tax will become a part of its expenses of production, and a charge on its privileges. In such a case, the law should recognise the tax as a business deduction for income-tax purposes.

If, on the other hand, the company tax is of the nature of an income-tax on corporate income, it is clear that the determining factor must be its incidence on persons. Ultimately, corporate income belongs to and is received by persons who may or may not be liable to income-tax. If the profits of companies are taxed, the real incidence of the tax is undoubtedly on those who receive corporate income. Whatever legal life a corporation may have, it has no real life ; a deduction from its income means a deduction from its shareholders' income. Hence a necessary condition for taxing companies is the provision for the avoidance of double taxation. Double taxation is not avoided merely by exempting the shareholders' corporate income from income-tax. The incidence of the company tax on the shareholders' *dividend-income* must not be in any way different from the incidence of income-tax on his

[1] Such provisions are found in Canada, Australia, South Africa, New Zealand and Great Britain.

[2] And taxes on capital and transfer of shares are found in many European countries to-day such as France, Belgium, Italy and Spain.

other income. This means that there should be a provision for refund to the tax-payer if his personal rate is lower than the company rate, and for payment of the excess to the State if his personal rate is higher than the company rate. Where company taxation is not accompanied by such a scheme, the incidence of taxation becomes unequal, corporate income being differentiated adversely as against other income ; and as poor persons may have corporate income as well as rich persons, it may probably result in making the tax system regressive.

It is clear, then, that from a theoretical point of view—whatever may be the foreign practice—corporations as such have no special taxable capacity. The individual's ability to pay on his corporate income is in no way different from that determined by his total income. Any levy of a company tax unaccompanied by a scheme of refunds thus differentiates against one particular part of the tax-payer's income, and indisputably conflicts with his ability to pay. England and South Africa, as we have seen in the preceding section, recognise the truth of the principles enunciated above by treating companies as agents. As regards the other countries, the very fact that they exempt dividends from a second levy of income-tax shows that they do not completely believe in the theory on which their company taxation is apparently based.

COMPANY TAXATION IN INDIA

The Present Position :—The Indian income-tax is imposed on the total corporate profits of companies at the maximum rate of 18 pies in the rupee. They are also subjected to a super-tax of one anna in the rupee on their profits in excess of Rs. 50,000. Companies with incomes below Rs. 50,000 are exempt from the super-tax.

So far as the procedure for assessment is concerned, companies are treated like normal individuals ; the princi-

pal officer of the company has to send in a signed return of income accrued during the previous year ; he is also liable to be called upon to produce accounts and other relevant documents in support of his return. In case he fails either to send a return or submit accounts when called upon to do so, the company is deprived of the right of appeal.

So far as income-tax is concerned, the company is empowered to deduct tax at the maximum rate from its dividends before they are paid to the shareholders. The principal officer of the company has to issue along with the dividend warrant[1] a statement specifying the amount deducted by way of income-tax on the dividend and the rate at which it was deducted. The person who receives the dividend when filling in his personal return, has to enter not only the actual amount he received but also the amount deducted by way of income-tax ; the dividend paid plus the tax deducted forms his income from the company, and is taken into account in determining the rate of his tax. He is, however, exempt from income-tax on the dividend element of his income, as it has already been taxed at source. But if the rate of tax applicable to the individual's total income is less than the maximum rate, (at which the tax is deducted on these dividends by the company) he can apply for a refund of the excess tax thus paid, and the State is bound to give him relief. There is thus no doubt that so far as the payment of income-tax is concerned, the company acts as an agent for its shareholders. It is obvious that the tax is not levied on the companies as such, but is only a convenient expedient for taxing the shareholder's income.

The payment of super-tax by companies stands on an entirely different footing. The flat rate of one anna in the

[1] To make things clearer it may be provided that in addition to the certificate of payment of income-tax, no company should be allowed to issue its dividends income-tax free. This will clearly bring home to the shareholder the fact of his *dividend-income* being taxed at source.

rupee is levied on the company as *such,* and is assessed on its total profits. It is not allowed as a business deduction. The shareholders are not exempt from super-tax on the dividend received, and at the same time they are not allowed to claim any refunds of the super-tax paid by the company. In fact, these dividends are subject to double taxation, once to the flat rate of the company super-tax, and a second time to the graduated rate of the personal super-tax.

We may, here, notice another case of double taxation. Certain companies hold shares in other companies; the latter companies are taxed on their income, and the shareholding companies are again subjected to super-tax on the income which they receive from the taxed companies. In this way the holding companies are required to pay double super-tax on their corporate income.[1]

Briefly speaking therefore, companies in India are subject to the maximum rate of income-tax along with a flat rate of super-tax on their total income. When paying income-tax, the companies act as agents for their shareholders; when paying super-tax they are supposed to act for themselves.

CRITICISM AND SUGGESTIONS REGARDING COMPANY TAXATION IN INDIA

Income-Tax on Companies :—There is no criticism to make on the Indian Income-tax as at present imposed on companies; it is levied in accordance with the theory we have enunciated above, the companies being in effect treated as taxing agents at source of the corporate income of their shareholders.

[1] The injustice of this position has been frequently pointed out by the Associated Chambers of Commerce in India, and latterly, the Federation of Indian Chambers of Commerce and Industry. It has at last managed to attract the attention of the Finance member who in his budget speech for 1930-31 promised to reform the position as early as possible.

Super-Tax on Companies :—The super-tax on companies is levied on an entirely different basis. We have seen that while companies are subjected to super-tax on their total profits, corporate income is again subjected to super-tax in the hands of the individual. Whether this constitutes double taxation is a question of great controversy. It is asserted with vigour that the company super-tax is entirely distinct from the personal super-tax, and that it reaches only the taxable capacity of the company ; and that therefore there can be no double taxation.[1] The company gets certain privileges[2] and pays for them by way of this super-tax. If this argument was correct, the tax would not have been imposed on the profits of the company ; and even if so imposed, it would have been allowed as a business deduction. The fact that such a deduction is expressly prohibited, makes it clear that the argument is not carried to its logical conclusion.

Moreover, if we look at the company super-tax from a historical point of view, we find that there is no basis for asserting that it is a tax on their special privileges. When the super-tax was first introduced in India in 1917, companies were subjected to the graduated rate on the personal scale on their undistributed profits, their distributed profits, in the shape of dividends, being taxed, directly from the assessee. In 1920, as a result of the agitation carried on by the mercantile community, the companies were relieved from the graduated tax on their undistributed profits, and made liable to a new super-tax at a flat rate of one anna in the rupee on their total profits in excess of Rs. 50,000. The new super-tax was a sort of compromise ; instead of getting their undistributed profits taxed only once but at the high graduated rates, the

[1] This is the official view, vide Sundaram's Law of Income-Tax in India, p. 186.

[2] The privileges enjoyed are :—(1) Limited liability, (2) Corporate finance. (3) Freedom of transferring and selling shares, (4) Publicity of audit etc., (5) Right of shareholders to enforce liquidation.

companies were now taxed on their total profits, but at a flat rate of one anna in the rupee. It is thus abundantly clear that, far from being any return for special privileges, the super-tax on companies is only a modified attempt at taxing undistributed corporate profits which generally evade the personal tax. The present super-tax is levied on total profits, instead of merely on the undistributed portion, because the rate is flat and rather low, as compared with the high graduated rates of 1917.

It can be asserted, therefore, that the present super-tax on companies is not based on any special 'ability', it is in effect an additional rate of income-tax on distributed corporate income. It follows that unless its incidence is similar to that of the personal super-tax, that is, unless it is accompanied by a concurrent provision for refunds when the tax-payer's personal rate is lower than the company rate, the tax will undoubtedly be in the nature of double taxation. The Indian super-tax on companies makes no provision for refunds to those who are not liable to a personal super-tax of one anna; it also makes no provision for excess payment tax on their undistributed corporate profits by those whose personal rate is higher than one anna. In other words, undistributed corporate profits are taxed at a low flat rate, without any reference to the personal rate of the shareholder who owns those profits; at the same time, distributed corporate profits pay two super-taxes, in addition to the income-tax legitimately due from them. The existing super-tax on companies, therefore, involves double taxation of corporate profits.

We shall now consider how this double taxation affects the general incidence of the income-tax. Individuals who pay the tax on corporate profits pay on the whole a much larger amount than those whose incomes are derived from other sources. For example, persons with equal amounts of income will pay unequal amounts of tax under certain conditions. If we take as an illustration two persons

whose incomes are Rs. 12,000 each, one deriving his income entirely from dividends, and the other entirely from other sources, the incidence of income-tax will work out as under :—

Description	Amount of income	Tax paid	Rate of tax[1]
Person whose income is entirely received from other sources	Rs. 12,000	Rs. 562-8-0	4·5 p. c.
Person whose income is entirely received from companies	12,000	1312-8-0	10·9 p. c.

The example chosen is of course an extreme one, but effectively illustrates the great injustice brought about by the company super-tax in certain cases.

The second effect of this double taxation on the incidence of income-taxation in this country is to destroy the fair progression of the tax, especially as regards persons receiving corporate income. To revert to the same illustration, a person with an income of Rs. 12,000 pays tax at an effective rate of 10.9 per cent. merely because his income is derived from companies ; whereas another person whose income amounts to Rs. 50,000 pays only at the rate of 9.4 per cent. simply because he has no corporate income. The net result of the super-tax on companies is thus to vary the rate according to the proportion which the individual's corporate income bears to his total income. This is entirely opposed to the theory of ability to pay which varies the rate of tax in accordance with the amount of a person's income. Since the very justification

[1] The detailed figures work out as under :—
On Rs. 12,000 at the normal rate of 9 pies in the rupee, 562-8-0.
On Rs. 12,000 at the company super-tax of one anna in the rupee, 750-0-0
Total tax paid by a person whose income consists solely of dividends, Rs. 562-8-0 plus Rs. 750-0-0=Rs. 1312-8-0.

of taxation of income is the doctrine of 'ability', it is abundantly clear that anything which conflicts so violently with 'ability' ought not to exist in a scientific system of income-taxation.

Extent of the Grievance :—The problem is not a theoretical one claiming mere academic discussion. It is not possible to ascertain accurately the number of persons who, though not liable to the personal super-tax on account of their incomes being below Rs. 50,000, are still compelled to pay this additional super-tax on their corporate profits. From official figures[1] it appears that in 1927-28, 29,519 persons got refunds of excess tax collected at source on their income from companies. As the tax is deducted at the rate of 18 pies, it is clear that there are at least 29,519 recipients of corporate profits with their total income below Rs. 50,000. These figures of refunds do not represent the total number of recipients of corporate profits, whose total incomes are below Rs. 50,000; because the tax-payer is given the option either to claim the refund or get the excess tax set off against the tax due from him on his other income. If we assume that tax-payers exercising this privilege number as many as those claiming refunds,[2] then, the total number of persons receiving corporate incomes (other than those whose incomes are above Rs. 50,000) amounts to 59,038. All these persons pay, in effect, the company super-tax of one anna in the rupee on their corporate profits.

While thus persons not liable to super-tax pay super-tax on their *dividend income,* persons liable to super-tax pay on their distributed corporate profits at a uniformly higher rate of one anna in the rupee. Thus the double taxation extends not only to individuals with small incomes but also to the richer assessee with incomes above

[1] Vide, All-India Income-Tax Report, 1927-28, Return III.

[2] They are probably more, as most tax-payers subject to income-tax have other incomes in addition to corporate profits.

Rs. 50,000, so far as their distributed corporate profits are concerned.[1]

THE EXEMPTION OF COMPANIES WITH INCOMES BELOW RS. 50,000

There is no reason why companies with incomes below Rs. 50,000 should be exempt while companies with incomes above that amount should be subject to tax on the excess above that limit. The exemptions and abatements are not based on any well thought out idea of the ultimate incidence of the tax; for there is nothing to prevent rich persons holding shares in companies with incomes below Rs. 50,000. The exemption is based on the false analogy of companies being equated to persons and probably results in a comparative maldistribution of the tax-burden. Poor persons who may not even be subject to the income-tax or if subject, might be liable only at a low rate, pay the company super-tax if their corporate income is derived from companies with large incomes; conversely, persons with big incomes do not pay this company super-tax if their incomes are derived from companies whose annual profits are below Rs. 50,000. Though the company super-tax is in itself not justifiable, this exemption further aggravates its injustice at the expense of persons with small incomes.

HOLDING COMPANIES AND SUPER-TAX

One more grievance arising out of the existence of this super-tax on companies is to be found in the case of what

[1] In their case, however, they pay only one anna on their undistributed corporate profits while their personal rate may be much higher. This again makes for different treatment to similarly situated persons; for example, if the company on whose dividends the assessee is paying super-tax entirely distributes its profits, the assessee pays on it his personal super-tax and the company super-tax. If on the other hand the company keeps a large amount of its profits undistributed, then the assessee pays on it only one super-tax and that too at the flat rate of one anna. The net result is that persons who receive dividends from companies which distribute all their profits pay at a higher rate.

are known as holding companies. A holding company is a company which from motives of efficiency splits up its business, and conducts it through the machinery of other companies, the first company controlling the second by holding most of its shares. A prominent instance of such a holding company is Steel Brothers, Limited, who own half the shares of the Indo-Burma Petroleum Company, who in turn are shareholders in the Attock Oil Company, Limited, of Rangoon. The income which Steel Brothers receive from these subsidiary companies pays the company super-tax thrice, once through the Attock Oil Co., again through the Indo-Burma Petroleum Co. and also directly through themselves. There are other cases in the country of holding companies ultimately paying a super-tax of more than 2 to 4 annas on their corporate profits. A request was made to the Indian Government to exempt holding companies from such double payments of company super-tax; the request was negatived, Government stating that each subsidiary company enjoyed the advantages of corporate capital and limited liability, and consequently there was no anomaly in each of them paying the tax. [1]

We have already pointed out how companies have no special tax-paying ability. It is obvious therefore that the imposition of super-tax on corporate income three or four times is clearly a case of double taxation. This burden is in addition to its inequitable incidence on income-tax paying persons. It may be argued that holding companies are but stepping stones to combinations and monopolies, and hence taxing them twice is justifiable. Apart from the question of the desirability or otherwise of monopolies, it should be remembered that as the law stands to-day there is nothing to prevent the formation of holding companies. If monopolies are to be discouraged, it should be done by direct legislation—possibly on

[1] For the whole correspondence, Vide, Appendix G. 4, B. C. C. 1921.

the lines of the American Trust Legislation—and not by this invidious double taxation.

SUPER-TAX AND UNDISTRIBUTED CORPORATE PROFITS

We have hitherto been discussing the double taxation caused by the super-tax on companies. This double taxation, with all its incidental effects, however, arises only when the company distributes its profits. So long as the profits are undistributed, the rate of tax paid is only one anna in the rupee ; as a matter of fact, whereas non-corporate income pays super-tax at the graduated personal rate, the undistributed income of companies only pays the flat rate of one anna. Thus business concerns owned by individuals are handicapped in their competition with joint-stock companies, the latter being better able to extend their business as their reserves are comparatively lightly taxed as compared with the former. [1]

Besides, the exemption of corporate undistributed profits from the personal super-tax results in a great loss of revenue. [2] There is nothing in the Indian Company Law to prevent the formation of private companies which are really one man companies ; and, similarly, nothing prevents a shareholder of a public company owning the majority of shares and thus practically becoming its owner. The result is that wealthy individuals subject to the personal super-tax find it convenient either to start private companies or acquire control of public companies, and then let their corporate profits remain undistributed. It is true that if these are eventually distributed in the form

[1] This factor is recognised in Australia, individual businessmen being allowed rebate of tax on 15 per cent. of their business income at a rate equal to the excess of the rate paid by them over the rate at which companies are taxed.—Income-Tax in British Dominions, p. 246.

[2] This is borne out by the bill now before the Assembly which aims at taxing such undistributed profits.

of dividends, they will be subject to the personal super-tax. To avoid this, undistributed profits are often capitalised, and issued in the shape of bonus shares; or the extension of the company's business results in an increased value of the original shares, which the shareholders can easily realise by sale. Again, the companies, after accumulating undistributed profits for a long while, can subsequently go into voluntary liquidation; the undistributed profits will then be distributed in the shape of the capital assets of the company and the shareholders can thus escape the personal super-tax.

Summary:—Summing up the results of our analysis of company taxation in India, we find that the position deserves no criticism so far as the income-tax is concerned. It is the super-tax which is open to the following objections:—

First, the super-tax on companies is a clear form of double taxation of the tax-payer's income in so far as it consists of distributed corporate profits; and in the absence of refunds, it violates the principle of ability to pay.

Second, it makes the tax system unequal, and interferes with the proper progression of the tax. In this way also it is opposed to the doctrine of ability to pay.

Third, while the super-tax on companies is itself not justifiable, its injustice is aggravated by the meaningless exemption of companies with incomes below Rs. 50,000. The exemption is made on a false conception of the company as a real person, and should be immediately abolished.

Fourth, imposition of super-tax on holding companies as well as on their subsidiary companies is another instance of double taxation, and cannot be justified.

Fifth, while the poorer shareholders suffer double taxation on their corporate income, the richer shareholders escape the personal super-tax on part of their corporate

profits by allowing them to remain undistributed and by capitalising them in course of time.

On all these grounds therefore, it must be concluded that the Indian tax on companies as existing to-day is not justifiable. Historically considered, it is a substitute for the graduated taxation of undistributed profits. As it stands to-day, it does not fulfil that function, while its incidence definitely conflicts with the individual's ability to pay.

Suggested Reforms:—It is recommended therefore that the super-tax on companies should be abolished; distributed profits of companies should be liable to the personal super-tax as at present. Concurrently with this reform, provision should be made to tax the undistributed profits of companies on the lines followed by the British Income-Tax system.

IMPENDING LEGISLATION ON COMPANY TAXATION[1]

It is interesting to note that there is a bill pending before the Indian Legislative Assembly which seeks to tax the undistributed profits of those companies which are predominently owned and managed by less than 5 persons. In such cases, the company is to be exempted from the flat rate of super-tax, but its undistributed profits are to be directly assessed in the hands of the shareholders, as if they were distributed—according to their holdings and shares. When the company denies such liability, elaborate provision is made for reference to a Board of Referees with a non-official majority and a non-official president. These provisions are not to apply to subsidiary companies and companies in which the public are substantially interested.[2] The scheme is very partial, and will differentiate

[1] The amended bill along with the report of the Select Committee is published in Part V, Gazette of India, dated 2nd March 1929.

[2] The evidence of such substantial interest is to be found in 25 per cent. of the shares being owned by members of the general public as also quotation of the share in the general share market.

between different companies, unless the company super-tax is completely abolished. Again, the exclusion from the scheme of companies in which the public are substantially interested practically nullifies the effect of the provision. At the same time, there is no reason why public companies should be made to pay the company super-tax with all its injurious effects, while the income from private companies should pay super-tax at rates suited to the shareholder's personal ability. The scheme is thus a half-hearted and partial attempt to solve the problem. It must be again emphasised that any attempt to tax the undistributed profits of companies must be preceded by the repeal of the company super-tax.

We have already recommended that the undistributed profits of companies should be charged to income-tax on the British model.[1] Our suggestion, however, proceeds on the assumption that the super-tax on companies will be abolished. If a reasonable share of the profits are not distributed, the Income-Tax Officer should be given discretionary power to tax the company's undistributed profits as if they were divided and received by the shareholders in accordance with their holdings of shares. This will prevent companies from hoarding enormous resources of undistributed profits, at the same time it will not penalise their building up of reasonable reserves. In cases where the company feels itself unjustly treated, it may be allowed to appeal against the Income-Tax Officer's decision to the New Board of Tax Appeals that we suggest in a later chapter. The Income-Tax Officer should also be given power to scrutinise the details of companies ; and if he finds either that the private company is a one-man concern, or that the public company is chiefly controlled by one person and his dependents, he should treat it as a family-corporation and subject them to super-tax on the whole of their profits both distributed and un-

[1] The British system has been explained in an appendix.

distributed. This will prevent rich assessees from evading super-tax on their corporate income.

The reforms suggested above will also meet the other cases of injustice in incidence arising from the super-tax on companies. The abolition of the company super-tax will automatically do away with the exemption of Rs. 50,000 for companies. It will also prevent double taxation of holding companies. In other words, the abolition of the company super-tax accompanied by suitable provisions for taxing undistributed corporate profits will result in placing Indian company taxation on an equitable basis.

PARTNERSHIPS

The Present Position:—For purposes of the Indian Income-Tax, firms are divided into two classes viz.

1. Registered firms.
2. Unregistered firms.

Registered firms are firms the partners of which have registered with the Income-tax officer a regular deed specifying the respective shares of each of the partners. These partnerships are treated like companies for purposes of income-tax, being charged at the maximum rate, while the partners are allowed refunds if their personal rates are less than the maximum. Registered firms are not subject to super-tax, but the partners are directly assessed to super-tax in respect of their income from such firms. As in the case of companies, registered firms have also no taxable minimum and all of them are subject to income-tax.

Unregistered firms are partnerships, the partners of which have not deposited with the Income-tax officer any statement regarding their respective shares. They are treated just like individuals for purposes of income-tax and taxed at the personal rates without any provision for refunds; at the same time, the partners of unregistered

firms, though exempt from income-tax on their income from such partnerships, have yet to include it in their tot. income which will determine their personal rate. Ur registered firms with incomes below Rs. 2000 are exemp from income-tax, but the partners are taxable in respe of their income from such firms.

Unregistered firms are also subjected to the graduate personal super-tax. These firms are treated just lik individuals, and are exempt if their incomes are belo Rs. 50,000. On the excess above Rs. 50,000, the pay super-tax at the graduated personal rates. Partne of unregistered firms are not personally liable to supe tax in respect of their income from such partnerships this income is not included in the return of their total ir come, and therefore is not taken into account in calcula ing their personal rate of super-tax on their other income

Thus under the present law, registered firms and ur registered firms—both partnerships—are treated on tw widely different bases. Registered firms are treated lik companies, and though liable to income-tax, it is clearl understood that they are merely agents for collecting a source the tax due from the partners. Unregistered firms on the other hand, are treated like individuals, being liabl to both income-tax and super-tax at personal rates.

INCIDENCE OF THE TAXATION OF PARTNERSHIPS

Registered firms :—No remarks are necessary as re gards the taxation of income derived from registere firms. Though liable to income-tax, it is clear tha accompanied as the taxation is with provisions for refunds registered firms are only agents for collecting at sourc the tax on the partner's income. They are not subjecte to super-tax.

Unregistered firms :—Unregistered firms, on the othe hand, are treated just like individuals, and subjected t

tax at the graduated personal rates. It is obvious, that as there are no provisions for refunds of excess payments, great injustice may naturally follow from this procedure; for example, let us assume the existence of an unregistered firm getting an income of Rs. 20,000 having two partners A and B, of whom A has a total income of Rs. 50,000 and B Rs. 8,000. Let us also assume that A's share of the profits of the firm is Rs. 14,000 and B's share Rs. 6,000. On the present scale of rates, the position relating to their respective payments of tax will be as under[1] :—

Income Grade	Total tax payable if income had been solely from other sources	Tax actually paid	Difference in Amount	Difference in Rate
Rs.	Rs.	Rs.	Rs.	
A: 50,000	4,688	3,937	−751	−1·5 p. c.
B: 8,000	250	344	+ 94	+1·8 p. c.

It is clear from this table that not only does the income-tax on unregistered firms differ in its incidence from that of the general income-tax, but also that the difference is in the direction of regression. The poorer partners of unregistered firms pay at a higher rate than is warranted by their total income; conversely, the richer partners pay at a lower rate than is warranted by their total income. Thus the tax payments are directly in contrast with the individual's ability to pay.[2] It is impossible to ascertain the

[1] Tax paid by the unregistered firm	Rs. 937
Share of A in the tax ... $\frac{937 \times 14}{20}$	656
Share of B in the tax ... $\frac{937 \times 6}{20}$	281
Tax paid by A on his other income	3000
Tax paid by B on his other income	63
Total tax paid by A	3937
Total Tax paid by B	344

[2] This conclusion is unavoidable, unless we make the rather improbable assumption that the partners of such unregistered firms have no other income, and also that their shares of the income from such firms are absolutely equal.

number of unregistered firms as the income-tax returns d
not give any such details, but looking at the fact that 30
unregistered firms paid super-tax in 1926, there must b
a considerable number of firms paying only income-tax
The injustice caused by treating them as individuals i
therefore undoubtedly real.

The official explanation for this special treatment of un
registered firms is the desire not to put them to the troubl
of claiming refunds, assuming that the partners of most o
them would otherwise have to do so. As stated above
it is impossible to ascertain how far this object is carrie
out ; but it appears strange that in spite of the inducemen
offered by this special treatment, so many registered firm
evidently refused to succumb to the temptation as can b
seen from the figures given below. In 1926-27, out o
the registered firms assessed to income-tax, 942 person
claimed refunds as having their incomes below Rs
50,000.[1] If we assume each firm to have four partners
then more than 52 per cent. of the partners of registere
firms applied for refunds. It is clear therefore that busi
ness men prefer to remain partners in registered firms
and be taxed at the maximum rate with provision for re
funds rather than convert their partnership into unregis
tered firms, and thereby secure the doubtful privilege o
being taxed at graduated personal rates. Thus, the taxa-
tion of unregistered firms results in a heavier incidenc
on poorer persons while letting off the rich ones lightly.

When we analyse the incidence of the super-tax o
unregistered firms, we find still stronger support for ou
view that the tax is partial to those with greater ability t
pay. For purposes of income-tax, partners of unregister-
ed firms are required to include their partnership incom
in their total income, so that at least on their other in-
come, the rate of the tax may have direct reference t

[1] Compiled from Return III, All-India Income-Tax Report and Returns 1926-27.

their ability to pay. As regards super-tax, on the other hand, while the unregistered firms continue to be treated as individuals and are exempt on their first Rs. 50,000, the partners of such firms are permitted to exclude their income from such partnerships from their total income. In other words, individuals pay super-tax on their partnership income at the partnership rate, and on their other income at a rate determined with reference to only the amount of their other income. This benefits the richer tax-payer in two ways; first, he can get his business divided into numerous unregistered firms, each of which will be exempt on its first Rs. 50,000; the rate of tax paid by each of these firms will be much less than its real rate, which is the one which would apply to their collective income, as they all belong to one person. Second, rich individuals whose income is derived from unregistered firms not only pay at a lower rate on their partnership income (as in the income-tax), but owing to the exclusion of such profits from their total income subject to super-tax, the super-tax paid by them even on their other income is at a lower rate, than that warranted by their total ability to pay.

In this way, the treatment of unregistered firms as individuals, though they are associations of more than one person, results in making the income-tax on such partnership income regressive. It presses hard on the poorer partners, making them pay more than their due, while taxing the richer ones at much less than their real ability as determined by their total income. Undoubtedly the taxation of unregistered firms on the same lines as individuals conflicts with the doctrine of 'ability to pay', on which alone the income-tax can be based.

THEORY AND PRACTICE OF TAXATION OF PARTNERSHIPS

From a theoretical point of view, there is no doubt that as partnerships mean more than one individual, any tax

levied on them should result in the same incidence of taxation on the partners as will be caused by a general income-tax. If the taxation of partnerships brings about any other result, it is certainly not consistent with the individual's ability to pay. In practice, the truth of this contention is recognised by most foreign countries. Thus, in the Dominions, though partnerships are liable to send in returns of income, the partnership itself is not subjected to income-tax, the partners being directly assessed in respect of their income from such partnerships.[1] The United States of America follows a similar practice.[2] Great Britain follows a slightly different method. Partnerships are required to send in returns of their incomes, specifying the shares of the partners. The partners in turn are also required to make separate returns of their income. The two returns are considered together and the personal rate of each of the partners is determined after consideration of the total income from all sources of each; the partnership is then assessed in respect of the tax payable by the partners on their partnership income.[3] The partnerships are thus not taxed at the maximum rate; and there is no necessity for any refunds.

Super-tax is not levied on partnerships in any of these countries. The income from the partnerships are of course assessed directly to super-tax in the partners' hands.

[1] In South Africa, partners are liable to make a joint return, but are liable to tax in their individual capacities only. In Canada, persons who are carrying on business in partnership are liable for income-tax only in their individual capacities. In Australia, partnerships are liable to furnish a return of the partnership income, but they are not liable to income-tax, the partners being assessed directly. In New Zealand partners are required to make a joint return but each is assessable as an individual. Vide Income-Taxes in British Dominions, pp. 65, 114, 252 and 355.

[2] Partnerships are required to send in returns of income, but the partners are liable only in their individual capacity. Spaulding, Ibid., p. 111.

[3] Vide Spaulding, Ibid., pp. 110-111.

THE INDIAN POSITION: CRITICISM AND SUGGESTIONS FOR REFORMS

The classification of partnerships into registered and unregistered firms and the different treatment accorded to them is peculiar to the Indian law; similarly the levy of super-tax on unregistered firms is also peculiar to India. The weight of foreign practice is undoubtedly against the Indian system. The All-India Income-Tax Committee of 1921 saw the absurdity of the Indian position, and recommended that the distinction between registered and unregistered firms should be abolished, and that all partnerships be taxed at the maximum rate with suitable provision for refunds.[1] They also recommended that if the individual partners file their statements of personal income at the same time, they were to be assessed directly at the appropriate rate. They were besides in favour of the abolition of the super-tax on unregistered firms with appropriate provision for the levy of super-tax at source on the income of non-resident partners. The recommendations of the Committee on this particular point, were turned down by the Select Committee of the Legislative Assembly. The latter Committee restored the original distinction and also subjected unregistered firms to super-tax. The reason they gave for this course was their fear that taxation at the maximum rate would cause great hardships to the poorer partners of unregistered firms, and that the hardships inflicted on the smaller assessees would outweigh the merits of the proposed abolition of the distinction.[2] We have already seen that this particular advantage claimed for the Indian system does not exist as a matter of fact. On the other hand, the system operates in favour of the richer assessees, who, by creating un-

[1] Vide Report of the All-India Income-Tax Committee, para 9.

[2] Cf. "We have come to the conclusion etc......amount of income"—Select Committee Report on clause 2 (14) of the Indian Income-Tax Bill 1922, Sunderam, p. XCV.

registered firms, can obtain an exemption of Rs. 50,000 on each firm, and can also get their rates modified. On the other hand, the alternative scheme we propose to outline below provides for just that advantage to the poorer assessees which does not exist under the present system.

We recommend that the present distinction between registered and unregistered firms should be immediately abolished. No partnership should be treated any longer as an individual, and the present super-tax on unregistered firms should be repealed. Partnerships should, as at present, be compelled to send in returns of their income, and should also be asked to specify the shares of their partners. The British system of taxing the partnership at the personal rate of the partners should not be adopted, as it will disclose to the partners each other's income. [1] If the personal returns of the partners show the whole of their partnership income (which can be ascertained by comparison with the partnership's return) the partners should be assessed directly in respect of that income. This will meet the case of the smaller assessees, who will then be taxed only at their appropriate rates. It is also in accordance with the practice of the United States and the British Dominions and has the further advantage of obviating the necessity for refunds.

HINDU UNDIVIDED FAMILIES

In view of the difficulties that have arisen regarding the taxation of Hindu Undivided families, we propose to consider this class of tax-payers under the following heads :—

(a) The Hindu Joint Family.

(b) A historical survey of the taxation of Hindu

[1] The weight of evidence before the British Royal Commission on Income-Tax was against this particular element of the British system of taxing partnerships.

Undivided families.

(c) The present position.

(d) The real incidence of the taxation of joint families.

(e) Criticisms and suggestions for reform.

THE HINDU JOINT FAMILY

The Undivided Family is an institution peculiar to the Hindu community.[1] The family in India does not consist merely of the father, mother and unmarried sons; it includes, in addition, married sons with their wives and children, the father and grandfather of the head of the family; and also nephews, cousins, and other relatives living with the family. It is not an uncommon thing to find Hindu families with more than 15 to 20 members all living together.

(i) *Members of the Joint Family*:—The property of such an undivided family is joint; in other words, the right of sharing in its proceeds is vested not in any one member of the family but belongs to all its members who are co-partners in the property. Every member of a Hindu family is, however, not necessarily a co-partner; only those who are three generations next to the holder in unbroken male descent can be coparceners;[2] in other words, only the sons, grandsons and great-grandsons of the holder of the joint property can claim joint ownership in the estate.

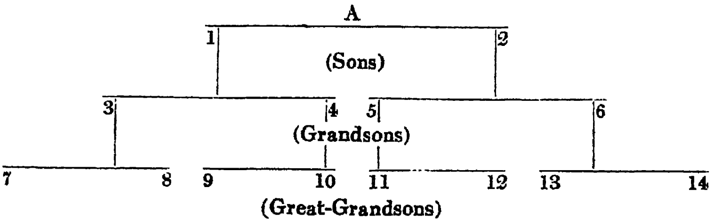
(ii) *Nature of the Joint Family*:—The nature of such ownership is a thing unique to Hindu Law. The ownership of the coparcenary property is in the whole body of the family. There is community of interest, and

[1] Cf. Mr. Mulla in the preface to his "Hindu Law". Also "other countries do not possess Hindu undivided families, and it is in this country that we have Hindu undivided families which are now sought to be made liable for the purpose of assessment". A. Debates, Vol. II, Part II, p. 2007.

[2] Vide Principles of Hindu Law, Mulla, pp. 210-221.

unity of possession between all the members of the family.[1] No one member of the family can claim any specific share of the joint property. Consequently no member is entitled to any definite share of the income from the property. The entire income of the joint family belongs to the common purse, and is available for the use of all the members; the interest of any one member is a fluctuating interest, being enlarged by deaths in the family, and liable to be diminished by births in the family. As these two factors are both uncertain as to the time and frequency of their occurrence, it is absolutely impossible to predicate any fixed proportion for each of the members on a partnership basis. The only thing that the members have definitely got—apart from partition after which the family will cease to be joint—is joint possession of the family property, and the right to be maintained at the expense of the joint income.

(iii) *Number of Coparceners*:—The number of such coparceners is a thing impossible to assert with definiteness. If we assume a normal Hindu family to contain two sons, and if we further assume A to be the holder of the joint property, then A will have to share the income of the joint property with the following 14 coparceners:—



It must be pointed out, however, that every Hindu undivided family need not have 14 coparceners. The actual

[1] Quoted in Ibid., p. 243.

number may probably be less. It is true that some marriages may result in no children, others may not be productive of male children ; while others may be productive of more than two male issues. We may assume that roughly, the number of coparceners of a Hindu joint property may vary from 5 to 10 persons. It must be noted that the number of coparceners refers to those who have a right to share in the property ; it is certainly not identical with the dependents whose number is much larger.[1] The coparceners need not be adults ; any member, provided he satisfies the condition set forth in the preceding table, can claim a share of the property. It does not matter if such claimants are minors, babies in arms or even children in their mothers' wombs.[2] The estates are managed by the father or in his absence the senior male member of the family who is called *Karta*. He has considerable discretion in managing the property and provided he spends its income only for family purposes, is not under any obligation to economise or save, as a paid agent would be.[3]

(iv) *Coparcenary Property* :—We shall now explain the essential conditions for a property to be coparcenary. Such a description is necessary as Hindus are not forbidden from holding 'separate property'. Joint Hindu property can be of two types : (1) Ancestral ; and (2) separate property of members thrown into the common Coparcenary stock.

Ancestral Property :—Property, if self-acquired, cannot be coparcenary so long as the original holder is alive ; after his death, however, it descends to his son, and then

[1] "A Joint Hindu Family consists of all persons lineally descended from a common ancestor and their wives and unmarried daughters...... A Hindu coparcenary is a much *narrower* body than the joint family" Mulla's Hindu Law, p. 210.

[2] "A son who was in his mother's womb at the time of partition is entitled to a share, though born after partition, as if he was in existence at the time of partition." Ibid., p. 317.

[3] Ibid., pp. 245-246.

becomes coparcenary and has to be shared with his sons grandsons and their sons. This is not confined only t immovable property. In Hindu law, a business is a dis tinct heritable asset.[1] If a Hindu dies, leaving his busi ness to his sons, and if the sons instead of partitioning th property decide to carry on the business jointly, then sucl business is joint family property, and the income fron such business is joint family income.[2]

Separate Property transferred to Coparcenary Pro perty :—Property, even if self-acquired by the member of the joint family, can become coparcenary property i either such earnings are the direct result of a use of th family property,[3] or if the members voluntarily throw i into the common stock with the intention of abandonin all claims upon it. For example, if five brothers live to gether and pool their separate earnings, the income is t be treated as joint family income.

(v) *Partition* :—The joint family ceases to be joint a soon as the property is partitioned or the shares of th income defined and set apart for the different members Otherwise, the presumption is that a family, once joint continues to be joint.

(vi) *Conclusion* :—Thus the Hindu undivided family i an association of many individuals related to one anothe by ties of blood, living together, and owning propert jointly. It is a separate legal unit; and its fundamenta feature is its oneness—the fact that the joint family in come belongs to all the members of the joint family re garded as one, and not in any defined individua proportions.

[1] Mulla's Hindu Law, p. 238.

[2] Such Hindu trading family firms are treated very differently fror ordinary registered firms. Ibid. pp. 239-241.

[3] If a joint family sends one of its members to England to pass th Indian Civil Service examination and meets his expenses, the incom of this member is not his separate property but forms part of the join family income.

A HISTORICAL SURVEY OF THE TAXATION OF HINDU UNDIVIDED FAMILIES

As we have seen above, the Hindu undivided family is for all legal purposes one unit. The income-tax law decided to treat it in the same manner, and taxed Hindu undivided families on the same basis and scale as individuals; the members of these families were of course exempted from tax on their income from such property, but there was no scheme of refunds if the member's rate was lower than the family's rate. This did not result in great injustice for, till 1916, there was practically no graduation in the tax. After 1916, the rates rose sharply on a progressive basis, and were again raised in 1921, and finally consolidated in 1922. In spite of the change in the position, Hindu joint families continue to be treated as before, on the same basis as individuals, and taxed at the personal rates.

It is when we come to the imposition of super-tax on the Hindu joint families that we find that the law pays attention to their peculiar nature. When the super-tax on incomes above Rs. 50,000 was first introduced in 1917, the Hindu undivided families were placed on the same position as companies, and partnerships.[1] Companies were taxed to super-tax only on their undistributed profits; on a similar analogy, Hindu undivided families were subjected to tax only on that portion of their income which was not paid or finally allotted to their members.[2] Just as shareholders of companies were directly assessed to super-tax on their dividends, similarly, members of Hindu un-

[1] Vide Report of Select Committee on the Bill—Appendix V, Sunderam's Law of Income-Tax in India.

[2] Total income was defined as meaning "Income accruing in the previous year from all sources except that in the case of a Hindu United Family, so much of the joint income of such family as had been actually expended or paid for the maintenance and other expenses of any member of such family or paid or finally allotted to any such member".—The Super-Tax Act, 1917.

divided families were also directly assessed in respect their joint family income. In short, Hindu undivide families were, so far as purposes of super-tax were co cerned, regarded as associations of individuals, and treat just like companies.

There was thus the anomaly of the Hindu joint fami being treated as an individual for purposes of income-ta and as an association for purposes of super-tax.

The super-tax was revised in 1920. The compani were then, as already explained, relieved of the graduat super-tax on their undistributed income, and subjected a flat rate of one anna in the rupee on their total profit The Hindu undivided families were deprived of the co cessions given by the 1917 Act, and treated on the san basis as individuals, even for purposes of super-tax. Inc viduals receiving joint family income were exempted fro super-tax on such income.

To sum up, the Hindu families have been uniform treated as individuals for income-tax purposes ; as regar super-tax, they were for a time (1917-20) treated as a sociations, but are now treated as individuals. Sin 1922, Hindu undivided families are treated as single inc viduals for the purposes of both income-tax and supe tax.

THE PRESENT POSITION

The present position with regard to the taxation Hindu undivided families is as follows :—

The Income-Tax Act specifically lays down that "person" includes a Hindu undivided family.[1] In oth words, for purposes of both income-tax and super-ta Hindu undivided families are treated just like individual and taxed at graduated personal rates. There is no pr vision for refunds if the individual's personal rate is le

[1] Section 2 (9), Income-Tax Act, 1922.

than the joint family rate ; nor is there any provision for the individual to pay the excess to the state if his personal rate is higher than the family's rate. Members of joint Hindu families are not only exempted from personal liability in respect of their joint family income, but such income is completely excluded from the consideration of his personal rate. For example, if a member of a joint family has a total income of Rs. 50,000, Rs. 30,000 of which is received from the joint family, the joint family pays tax on the 30,000 ; and on the remaining Rs. 20,000 the individual pays not at the rate applicable to Rs. 50,000, but only at the rate applicable to Rs. 20,000. Thus a member of a joint family pays tax on his separate income at a rate which has no reference to his total income. Besides, a special concession is shown to joint Hindu families, the taxable minimum for super-tax in their case being Rs. 75,000.

THE REAL INCIDENCE OF THE TAXATION OF JOINT FAMILIES

As Hindu joint families are treated on the same basis for both income-tax and super-tax, we need not separately analyse the incidence of both these taxes ; the conclusions of the one apply equally to the other.

The first fact to be remembered in discussing the incidence of taxation of joint families is that, though legally, members of a Hindu joint family form part of a single unit, yet in actual practice there are many families who do not live jointly. This fact makes a great difference. We shall therefore deal separately with these two types of Hindu families, viz.,

(1) Families joint in estate as well as in living.
(2) Families joint in estate, but not in living.

(1) *Families joint in estate as well as in living* :—Such an undivided Hindu family not only forms a single tax-

able entity, but even for living, it is one single unit. All the members live together, and none of the members receive individually any specified shares of the joint income. The *Karta* handles the whole of the family income, and is at liberty to spend it provided he does so for purposes of the family. Apparently, then, the law does not ignore facts when it taxes such a family as an individual. But it does ignore one essential factor, that the manager of a Hindu undivided family has, unlike an ordinary individual, to spend without any option a portion of the family income on maintaining the coparceners. The coparceners have a right of maintenance and can enforce it in a court of law. The expenditure so incurred by the *Karta* is a necessary expenditure, for which an allowance should be made. This is not done, and therefore, the present system of taxing such Hindu undivided families leads to taxation of necessary expenditure, which may be said to fall on the 'gross' income of such families.

(2) *Families joint in estate, but not in living*:—As distinguished from joint families, the members of which live together, there are joint families who own property jointly, but whose members live apart, only receiving the joint family income in certain informally agreed shares. The law treats these families as individuals, and there are no provisions for refunds. The following consequences arise from the taxation of these joint families as individuals.

(a) Individuals with incomes below Rs. 2,000, who are totally exempted from the ordinary income-tax, are yet taxed on that portion of their income which is derived from such Hindu undivided families. The extent of this grievance becomes greater, the higher the rate at which the undivided families pay tax. For example, if a Hindu undivided family pays tax at a rate of one anna in the rupee, and if a part of its income is distributed among persons whose total income is below Rs. 2,000, these

latter persons pay tax at this high rate, though under the ordinary income-tax law they would be totally exempt.

(b) Where the personal rate of the tax payable by the beneficiary of joint family income is less than the rate paid by the joint family, the individual pays at the higher rate on his joint family income.

(c) Where the personal rate of the tax payable by the beneficiary of joint family property is higher than the rate at which the joint family is taxed, the individual pays at a lower rate on his joint family income than warranted by his "ability".

(d) The exclusion of the individual's joint family income in determining his personal rate of tax makes him pay at less than his real ability even on his other income.

To sum up, the incidence of the taxation of such Hindu undivided families is totally different from the incidence of the normal income-tax. Poorer persons pay at a higher rate on their joint family income, while richer persons pay at a lower rate not only on their joint family income, but on their other income as well. In other words, the income-tax, though levied on a progressive scale on the joint family, becomes regressive on the shares of such joint family income. It also unnecessarily differentiates between joint family income, and other income, the net effect being against joint family income in the case of the poorer assessees, and in its favour in the case of the richer assessees.

CRITICISM AND SUGGESTIONS FOR REFORMS

From the foregoing discussion, it is clear that the doctrine of ability to pay is not the determining factor in the taxation of income from Hindu undivided families. On the other hand, some Hindu undivided families are taxed on their gross income, while in the case of the others the incidence of income taxation is in direct contrast with the individual's ability to pay.

This aspect was not entirely ignored when the Income-Tax Acts were being passed. To the report of the Select Committee on the Income-Tax Bill of 1918, Mr. B. N. Sarma added a minute of dissent, protesting against the treatment accorded to the Hindu undivided family.[1] His contention was that "the tax payable by an undivided family should be payable by several members of the family entitled to a share of such income as if the family became divided on the date on which the income became taxable". Mr. Sarma was not successful in converting the Imperial Legislative Council to his views. Similarly, in 1917, when the Super-Tax Act was passed, Pandit Malaviya wrote a minute of dissent, suggesting that "the taxable income of a Hindu undivided family should be calculated after deducting so much of the joint income of the family as would not be liable to assessment under this Act if all the members of the family had been divided on the date of assessment". He also pleaded that the total tax payable by such a family should not exceed the total amount that would have been paid by the members if the family had been divided.[2] His attempt was also unsuccessful. Again, in 1922, Dewan Bahadur Rangachariar tried to secure some special deductions for the joint family. Government contemptuously threw out his suggestion. More recently, Pandit Thakurdas Bhargava unsuccessfully moved an amendment to the Finance Bill which was in effect similar to that moved by Mr. Sarma ten years ago.

From the attempts made by these non-official members, it is clear that the universal remedy suggested was to treat the family as divided; in other words, while the Hindu undivided family should continue to be a unit of

[1] "The provisions of the Act in assessing Hindu undivided family will tend to disruption of the joint family system and are unfair to the members of such families......The taxation policy of Government grievously interferes with the family system of the Hindus." Vide Select Committee Report on Income-Tax Bill, 1918.

[2] Vide Select Committee's Report on the Indian Super-Tax Bill, 1917.

taxation like a company or a registered firm, the total tax payable by it should not exceed the amount that each member would pay on his share at rates adjusted to his individual total income. The law was asked to recognise the undivided family as a legal person, who represents many real individuals, and the institution was to be used as a machinery for taxing at source the members' *joint family* income.

This suggestion is theoretically very attractive, as it will adjust the tax paid by each member to his real ability, and thus bring the income-tax on Hindu undivided families into line with the general income-tax. But there are two strong objections that can be levelled against the scheme.

Firstly, the scheme treats the Hindu undivided family as a mere association of individuals formed on the same basis as a company or registered firm. This assumption entirely ignores the real nature of this peculiar Hindu institution. As we have already described, the income of the Hindu joint family does not belong to any member nor can it be divided in specified proportions among the members. So long as the family continues to be joint, its income is one, and it belongs to all. 'Community of interest' and 'unity of possession' are the essential features of the joint family ; the coparcenary extends to four generations, and may include persons of all ages, from old men of ninety to babes in arms. It is thus difficult to predicate the shares of the members ; the difficulty is increased when, as often happens, some of the coparceners are minors. Not only is it difficult to ascertain the shares of the members, but the very idea of sharing is also foreign to the nature of the family. The manager of the joint family spends its total income, and so long as he spends it only for purposes of the family, he is within his rights. This is the case, even when the other coparceners are adults, so that, the joint family income far from being shared, is spent by one person. In view of this the treat-

ment of the joint family on the same lines as a company ignores facts.

Secondly, any scheme of refunds or relief will be found to be almost hopeless to carry out in practice for families which are joint in living. We have already seen how it is administratively impracticable to make an allowance on account of dependents ; it becomes much more difficult to fix the rate of the tax with reference to each coparcener's total income. Some of them will be minors ; others may not be in actual receipt of income ; and a fraudulent tax-payer can easily escape his true liability by ostensibly dividing the income into many shares. It is, therefore, impossible to treat the Hindu undivided family as an association, and tax its income effectively. Besides, the division of the family income into shares is a sign of the dissolution of the joint family, and it is unfair on the part of the state to interfere with the continuance of a social institution by means of tax-measures.[1]

These objections are applicable in their entirety only to Hindu families which are joint in living as well as in estate. Where the members of the family live apart and receive income from the joint estate, the family behaves somewhat on the lines of an association of individuals. It is no longer one unit though spiritually it may continue to be so. The injustice of treating such a family as a single person immediately becomes patent. We may, therefore, justifiably apply to such families the same methods of taxation as are applied to companies. They may be taxed at the maximum rate, and refunds allowed to members whose personal rates are less than the maximum. Such a system will bring the taxation of these Hindu undivided families into line with the individual's ability to pay. To avoid the creation of fraudulent sharers of the joint family income, it may be provided that the

[1] Cf. Pandit Malaviya's Minute of Dissent to the Select Committee's Report on the Indian Super-Tax, 1917.

proportion of the shares returned for income-tax purposes, shall be regarded as holding good also for purposes of partition.

This treatment, however, cannot be applied to those Hindu families which are joint in living as well as in estate. The objections outlined above apply with full force to the application of any such scheme to these families. This does not mean, however, that the position should be left undisturbed. The income of such a joint family, though it may not be divided among its members, has much more necessary expenditure laid on it, for the coparceners of the property have the right of maintenance on the income. It may be provided, therefore, that such a joint family, though continuing to be treated as an individual, should be taxed only on the excess of its income over what is necessarily spent on the maintenance of its coparceners. Such a maintenance allowance should not exceed Rs. 1000 for adults and Rs. 250 for minors.[1] To prevent fraud, it may be provided that any person for whom an allowance is claimed as a coparcener will be so treated for purposes of partition as well. The excess of the joint family income over this expenditure will be its taxable income; allowances for children and marriage should not be given in the case of such families, unless the allowances claimed are on behalf of persons who are themselves not coparceners and who are yet the relatives of coparceners. This will prevent duplication of allowances.

Members of these families should be allowed, as at present, to exclude their joint family income from the computation of their personal rate, as they are really not in receipt of the joint family income. Members of the

[1] The maintenance allowance is taken at Rs. 1000 because when persons live together, the expenditure per head is on an average less than when they live apart. Rs. 250 is taken as allowance for minors as corresponding to Rs. 250 recommended as allowance for children in Chapter VIII.

other type of undivided families, however, who are not joint in living, do receive their joint family income separately and should be made to include it in their total income for purposes of calculating their personal rate.

In this way the income-tax on joint families will be based on a correct understanding of their true position as taxable units.

SUMMARY

The Hindu undivided family is a unique institution by which certain relatives, called coparceners, enjoy in common without separate shares a joint family income. In some cases, the members live together, with the manager receiving and spending the money ; in some others, the members live apart with the income distributed to different members. Under the present Income-Tax Law, they are treated just like individuals. The result is that taxation of these families falls upon the poorer members pretty severely, but lets off the richer ones lightly. The remedy proposed is to treat those joint families where the members live apart as registered firms, taxable at the maximum rate but with suitable provisions for refunds ; in the other case, of joint families living together, they should continue to be treated as individuals, as the income of the concern is received and spent by one person namely the *Karta* or manager ; but they should be allowed to deduct from their taxable income the necessary expenditure spent on the maintenance of the coparceners.

The scheme is not administratively impracticable. Evidently minute details of the Hindu undivided families are known to the Income-Tax Department.[1] The number of such families is not given in the official report ; but on the basis of certain calculations explained in Appendix

[1] Return IVA of the All India Income-Tax Report shows the knowledge of these details.

X,[1] it may be said that the number of Hindu joint families paying the tax in the year 1926-27 amounted to 37,476.

GENERAL REMARKS ON SPECIAL CLASSES OF TAX-PAYERS

During the course of this chapter, we have surveyed the three special classes of tax-payers who are subjected to both income-tax and super-tax. We have seen that except with the regard to the income-tax on companies and registered firms, the position is open to the gravest of objections. Corporate income, income from unregistered firms, and joint family income are treated differentially, as contrasted with the other incomes of the individual. The incidence of taxation on these special classes of tax-payers often tends to be regressive ; it presses hard on the poorer people ; it lets off lightly the richer ones. The chief reason for this difference in incidence arises first, from the treatment of the unregistered firm and the joint family as one individual, though they represent more than one person, and from the treatment of companies as if they had a separate taxable capacity whereas they have not ; second, from the practice of allowing the individual to exclude his income from unregistered firms and joint families from his total income for computing his personal rate, because of which his other income pays at a lower rate than warranted by his 'ability'.

We have therefore recommended that so far as companies, registered and unregistered firms are concerned, they should be treated as associations of individuals and taxed at the maximum rate with suitable provision for refunds. None of the institutions referred to above should be individually subjected to super-tax ; the super-tax should be collected in the case of such incomes directly from the assessee who receives it. As regards those

[1] The Appendix also contains details of earlier years.

Hindu undivided families which are joint in living as well as in estate, they should continue to be taxed as individuals and subjected to both income-tax and super-tax; but the tax must be levied only on the excess of their income over their necessary expenditure for the maintenance of the coparceners.

These measures will automatically effect the removal of the special concession given to income derived from such special classes of tax-payers, viz., their exclusion from the computation of their total 'income'. The beneficiaries from such special classes will then pay tax on their entire income at the rates applicable to their total income, and hence their ability to pay. In this way the existence of classes of tax-payers other than the individual will not in any way alter the incidence of income-tax, but will produce results similar in effect to those produced by the income-tax on persons. In other words, the taxation of the special classes of tax-payers will be in accordance with the ability to pay of the individuals who are represented by these special classes.

CHAPTER XI

The Problem of Double Taxation

The almost universal adoption of income-tax as a national fiscal weapon by different countries of the world has resulted in the peculiarly modern problem of double taxation, which has attracted world-wide attention. It is therefore appropriate that a separate chapter should be devoted to this problem with special reference to Indian conditions. We shall discuss the subject under the following six heads :—

1. The meaning of double taxation.
2. The theoretical position.
3. The Indian position.
4. A critical examination of the Indian position.
5. Objections to the abolition of the existing relief.
6. Conclusion.

THE MEANING OF DOUBLE TAXATION

Double taxation literally means paying tax twice on the same income. This, however, cannot be taken as a proper definition. We cannot assert that the mere fact of being taxed twice subjects the income to double taxation ; for example, if a resident of the country pays two taxes on his income by way of Provincial and Central income-taxes, as is the case in countries like Australia and the United States of America, he cannot be said to be doubly taxed, for the two entities which tax him form but parts of the one Governmental machinery of the country ; and taxation of the individual's income is a matter of mutual arrangement between these allied taxing authorities.

Similarly we cannot say that there is double taxation in cases where the individual pays two different taxes such as income-tax and customs duties, or income-tax and salt duty. If the taxes are all levied by the same Government, they are only different means for realising the individual's total tax contribution. In our discussion of the double taxation caused by the super-tax on companies, we gave a different meaning to the term. We employed it in the sense of taxation of the same income more than once for the purposes of one particular kind of tax. In this chapter we are concerned with the international aspect of double taxation, and shall therefore adopt the meaning usually given to it in foreign countries. When taxes are levied by different governments on the same income double taxation may arise ; in this chapter we are concerned with the problems arising out of such a situation.

As we have already observed, income-tax is generally an essential item in the financial systems of the world. It is levied on all incomes originating in the country, as well as on the entire income belonging to the residents of the country. This wide scope results in obvious complications. To take an extreme instance, if an individual resides in country A, and derives all his income from country B, he will then have to pay income-tax on his total income once in country B, where his income originates, and again in country A where he has his residence. This example illustrates clearly what we mean by double taxation. Double taxation does not arise if the individual derives all his income from the place where he resides. This, however, is not always the case, especially because of the growth of international commercial and industrial enterprise, and the persistent search of capital to find newer and more fruitful fields of investment. Modern income is a thing widely diverse in its origin ; and the place where the income arises is not necessarily identical with the place where the owner of that income has his

residence. Though the grievance of double taxation does not widely exist in the exact form given in our illustration, yet there are many cases where, as a result of the joint adoption of the principles of origin and residence, the individual pays income-tax to two different countries, though only on parts of his income.

THE THEORETICAL POSITION

In this section, we shall enquire into the validity of double taxation, discuss the hardships it causes to individuals, and finally examine the solution, if any, offered by economic theory.

Is double taxation justifiable? :—Double taxation of an individual's income by two or more distinct sovereign authorities has certainly got its theoretical justification. If an individual resides in a country, he is under certain economic obligations to the state which protects his property. The same is true of the country from which he draws his income. Thus an individual owes economic allegiance to the state where he lives as well as to the state whence he gets his income; and there is no reason why the state should not tax the person who is under its economic obligation.[1]

Hardships of Double Taxation :—Notwithstanding its theoretical validity, double taxation in practice causes great hardships to the individuals whose incomes come under its scope. Those whose incomes arise abroad have to pay on the same aggregate sum more by way of taxation, than those whose incomes are derived from the very country where they have their residence. Thus the individual with a "foreign" income is penalised as compared

[1] Cf. The Committee of experts appointed by the League of Nations to go into the problem of double taxation found its theoretical validity in the doctrine of economic allegiance. "Any individual pays to the state under whose economic allegiance he is and economic allegiance is to be found not only in the place where the income originates but also where its recipient resides."

with the one with a "domestic" income. Such a treatment seems rather unfair to the adventurous section of the community which seeks to bring home wealth from abroad.

The Seligman Committee's Solution[1] :—The committee of experts appointed by the League of Nations to enquire into the problem of double taxation consisted of Professors Seligman, Bruins, Einaudi and Sir J. C. Stamp. The committee elaborated the doctrine of economic allegiance, under the following heads :—

(a) Origin.
(b) Situs.
(c) Enforceability.
(d) Domicile.

By origin they meant the place where the yield is physically or economically produced ; by situs, the place where the final results like the complete production of wealth are actually to be found ; by enforceability, the place where the rights to handing over these results can be enforced ; and finally, by domicile, they meant, the place where the wealth is spent, consumed or otherwise disposed of.[2] They, then, proceeded to classify all income on the basis of these factors, finally grouping them under the two heads of domicile and origin. The result of their researches are reproduced below.[3]

[1] We have called it the Seligman Committee's report as even among that group of distinguished fiscal experts, Prof. Seligman is easily the most distinguished figure. Our nomenclature is strengthened by the fact that recently, Prof. Seligman has written a most notable book on the problem of double taxation.

[2] Report on Double Taxation, League of Nations, pp. 22-26.

[3] Ibid., p. 39.

Category of Wealth	Predominant Element	
	Origin	Domicile
Land	X	
Mines, Oil Wells, etc.	X	
Commercial Establishment... ...	X	
Agricultural Machinery	X	
Money, Jewellery, Furniture ...		X
Vessels	X	
Mortgages[1]		X
Corporate Shares...		X
Corporate Bonds		X
Public Securities...		X
General Credits		X
Professional Earnings		X

Criticism of the Seligman Committee's Report:—In a recent publication[2] Prof. Seligman has elaborated the scheme formulated by the Committee of which he was so prominent a member. While the work is undoubtedly a real contribution to the theory of public finance written in the author's lucid style, it does not meet the objections which we outline below, and does not go much beyond the recommendations of the Committee.

There are several grounds on which the report may be criticised. In the first place, the Committee themselves are not very optimistic about the validity of their conclusions. They confess that "to allocate the exact proportion of economic allegiance to origin or domicile in each particular category is well nigh impossible".[3] The classification which they have attempted in spite of this asser-

[1] Income from mortgages has residence as its predominant element, but if it is considered as property, the predominant factor is origin.

[2] Double Taxation and International Fiscal Co-operation.

[3] Report on Double Taxation, Ibid., p. 39.

tion is based on the crude method of assigning items which have a predominant element of origin to the place of origin, and of assigning the item with a predominant element of residence to the place of residence. Besides, they admit the relative impracticability of their method and opine in favour of the reciprocal exemption of non-residents by every country. Their elaborate analysis therefore cannot be taken as the basis for framing any practical measures for the alleviation of the hardships of double taxation. As a matter of fact, their conclusions were not accepted by the Committee of technical experts which met to consider their report at the instance of the League of Nations. The technical experts recommended the adoption of the principle of origin with some modifications in the case of the schedular income-taxes, while as regards personal income-taxes, they agreed that the burden of relief should lie with the country of domicile. As we shall see later their conclusions virtually agree with the principle enunciated by us for the solution of the problem of double taxation.

Even from the theoretical point of view, the Committee's recommendations are open to objection. The distinction they have drawn between 'situs' and 'enforceability' appears very thin, because the place where the income is to be found in its final form is generally the place where the rights can be enforced. There may be exceptions to this rule, but exceptions are no reason why 'enforceability' should have been classed as a separate factor and given such significance. Moreover, wherever such enforceability exists, the state takes its toll by means of stamp duties. This is an additional justification of our belief that 'enforceability' should not play any part in determining relief from double taxation. The analysis itself seems to have too much fineness for practical use, and Prof. Griziotti's distinction between the production of

income and its consumption appears much more reasonable.[1]

The Committee treads on slippery ground when in its zeal for an original classification, it asserts in a priori fashion that "what each country would lose in the one case it would roughly gain in the other". Such a statement, we need hardly add, is unwarranted, as its truth depends entirely upon the circumstances of every country, and cannot be made the subject of a general statement without detailed statistical enquiries. On these various grounds, therefore, we have to reject the classification formulated by this Committee as not suitable for practical purposes. Moreover, as we shall notice later, while the committee have dealt with economic allegiance, they have entirely ignored the significance of citizenship in determining relief from double taxation.

A correct theoretical assignment of the economic allegiance of income is therefore not possible, unless each particular income is made the object of a separate study by practical experts well versed in business. Instead of vainly attempting to discover a theoretical solution of the problem, we shall now undertake the much more fruitful task of finding a remedy for the hardships entailed in practice by double taxation.

The Principle on which relief from double taxation should be based in Practice :—Before framing any scheme of relief from double taxation, the primary thing to be determined is the question whether the proposed relief should be granted to doubly taxed income or doubly taxed individuals. Though all income is ultimately received by persons, doubly taxed income is not necessarily identical in respect of nationality with doubly taxed individuals. For example, if an Englishman living in England owns shares in a jute com-

[1] He recommended the criterion of 'origin' in the former and of 'domicile' in the latter case. See Seligman's Double Taxation and International Fiscal Co-operation, p. 151.

pany in India, and makes a profit of say, Rs. 20,000, he pays income-tax on it both to the Indian and British governments. In this case, the individual taxed doubly is an Englishman, while the income doubly taxed is Indian. Conversely, if an Indian receives income from England, he pays income-tax on it to both the British and Indian Governments. In this case, the individual doubly taxed is Indian, while the income doubly taxed is English. This distinction between doubly taxed income and doubly taxed persons is indeed fundamental, as upon it depends the enunciation and working of a right scheme of relief from double income-tax. Leaving theory apart, the practical question we have to ask is—continuing our example of the Englishman with incomes derived from India—whether India is prepared to give relief to doubly taxed Indian income, which means in effect relief to an Englishman, or a foreigner; or is India desirous of restricting such relief to doubly taxed Indians alone which means the grant of relief to Indian nationals. If the State decides for restriction of relief to doubly taxed Indian income, it will leave unredressed the hardships of Indians with foreign income while redressing that of the foreigners with Indian income; if, on the other hand, it is in favour of relief to only doubly taxed Indians, it will meet the grievance of all nationals, while leaving those of some foreigners unredressed. On the other hand, it is also open to the State to give relief to both doubly taxed Indians and doubly taxed Indian income. Before deciding on the proper principle on which double income-tax relief should be based, it may be of interest to note the following considerations.

(1) The duty of every state lies essentially to its citizens. Its business is primarily to redress the grievances of its own citizens. Any hardship suffered by foreigners should call for relief from the countries whose nationals they are. No state has any right to spend its revenue in

relieving non-nationals, unless such relief is absolutely necessary from the point of view of expediency, for example, a steady import of foreign capital.

(2) Even if every country grants relief only to its own citizens, foreigners will not suffer in practice, as they will obtain relief from their own countries. If every country restricts such relief to its own citizens, the problem of double taxation is automatically solved as every doubly taxed person will receive relief from his country. This will necessarily mean that all doubly taxed income obtains relief.

(3) As a matter of fact, several advanced countries are already following this principle of restricting double income-tax relief to their own nationals. Even the technical experts of the League of Nations recommended that in the case of personal income-tax, remission should be granted by the country of domicile which practically means the same thing as restriction of relief to nationals. Such a course is already practised in the United States of America, Canada, Italy and Belgium.[1]

We may conclude, therefore, that a country should grant relief only to its own nationals and residents. Such a grant of relief is a duty which all countries owe to their nationals, and if all countries perform this duty, the problem of double taxation will cease to vex politicians.

THE INDIAN POSITION

It will be convenient to treat this section under the following heads :—

[1] Both the United States and Canada allow their citizens to deduct from the income-tax due to them the amount paid already to other countries. In Italy, the law provides that "the Minister of Finance may exempt from income-tax Italian joint stock companies for their income derived from branches established in foreign countries, if such income is already taxed in the country where the branch is situated". As regards Belgium, "income arising out of the profits of trade or business realized and taxed abroad is taxed at one-fourth of the normal rates". Bernard's Taxation of Incomes, Corporations and Inheritances in Canada, Great Britain, France, Italy and Belgium, pp. 133 and 181.

(a) Double taxation by two or more taxing authorities in India.
(b) Double taxation by two or more taxing authorities in the British Empire.
(c) Double taxation by two or more taxing authorities outside the Empire.

Double Taxation in India:—We have already observed that if in addition to the Central income-tax, the Provinces also levy income-tax, they do not create double taxation. As a matter of fact this position does not arise in India. The same thing, however, cannot be asserted of the income-taxes levied by the Indian States. When an Indian pays income-tax both to an Indian State and the Indian Government, he is undoubtedly suffering from double taxation according to the terms of our definition.

There are 32 Indian States levying income-tax to-day, the most prominent among them being Baroda, Mysore and Travancore. Details of the States levying income-tax are given in the Appendix XI attached to this chapter. It has not been found possible to get at the details of the income-tax legislation of all these States. With the exception of exemptions and rates of tax however, the income-taxes of almost all these States are based on the system prevailing in British India. It is sufficient for our present purpose to note that most of these States tax all income received within their borders, without any regard to the place whence the income is derived.[1] The natural

[1] "Save as hereinafter provided, this Regulation shall apply to all income (profits and gains as described in or comprised in section 4) from whatever source it is derived, if it accrues or arises or is received in Travancore, or is under the provisions of this Regulation, deemed to accrue or arise or to be received in Travancore." The Travancore Income-Tax Regulation, S. 3, cl. (1).

"Save as hereinafter provided this Regulation shall apply to all income, profits or gains as described or comprised in section 6 from whatever source derived accruing or arising or received in Mysore or deemed under the provisions of this Regulation to accrue or arise or to be received in Mysore." Mysore Income-Tax Manual, Part I, section 4, cl. (1).

result is that persons resident in British India and deriving income from any of these States have to pay double tax on it if they receive it in British India ; conversely persons residing in these states and deriving their income from British India pay double tax on it if they receive it within the state. One of the States—Mayurbhanj—goes so far as to tax the entire income of its subjects irrespective of their residence, and the origin of their income.[1] This makes the net for double taxation even wider.

This double taxation resulted in great hardships to Indians engaged in business both in the States and in British India. This is not an unusual thing, as with all their difference in political status, British India and 'Indian' India form one integral economic unit. Representations were made from early times to the Indian Government to remove this defect, and as a result,[2] the amount of income-tax paid to Indian States was allowed as a deductible business expense in British India.

This concession, however, only touched the fringe of the problem. A person who paid income-tax both in British India as well as in one or more of the Indian States, was in a substantially worse position than his compeer, who had an equal amount of income, but derived it only from British Indian sources. In the year 1922, when the Income-Tax bill was before the Legislative Assembly, Rao Bahadur Rangachariar moved an amendment to section 49 to provide for relief from double income-tax with regard to income taxed both in British India and in Indian States.[3] The amendment was withdrawn on an

[1] "Any income, made by the State subject outside the State."

[2] Vide page 10, Punjab Annual Report, 1915-16, p. 10.

[3] The amendment ran :—"If any such person proves to the satisfaction of the Income-Tax Officer that he has paid income-tax for that year in respect of the same part of his income in any Indian State or elsewhere in the British Empire, he shall be entitled to a refund of the sums so paid which however shall not exceed one-half of the Indian rate of tax". L. A. D. Part II, Vol. II, pp. 2027-2030.

assurance given by Government that executive instructions would be issued to provide for such relief.

The promise materialised four years later, and on the 1st of July 1926, Government issued a notification[1] providing for partial relief for such double taxed income. The notification provided that when a person who has paid British Indian income-tax on any part of his income, has also paid on the same part of his income State income-tax in any part of the States, mentioned in the said notification, he shall then be entitled to a refund from the Indian Government of a sum representing half the rate of the State tax levied on his income. Such relief is not to exceed half the Indian rate of tax. The State, in return, refunds to the double taxed person the other half of the State tax.[2] Thus, in effect, an Indian having his income taxed both in British India and Indian States will pay only the higher of the two income-taxes. Under present conditions, this means that a resident in British India receiving income from Indian States will really pay only the British Indian rate of tax; thus he will not be penalised as compared with his brother, who receives his income solely from British Indian sources.

Double Taxation in the British Empire:—We shall first consider the case of income taxed both in Great Britain and British India and then discuss the double taxation of income as between India and the Dominions.

India and Great Britain:—Great Britain, as we have already seen, taxes income on the basis of both 'origin' and 'residence'. The scope of her income-tax is thus comprehensive. India, on the other hand, though partial to income from salaries and securities receivable abroad, rigorously taxes income from business carried on in India, without any regard to the place where such income is receivable. The natural result is, that in many cases, there

[1] Vide Appendix XI.

[2] Cf. Income-Taxes in British Dominions, p. 231.

is double taxation of the same business income by the British and Indian Governments. When one remembers the huge volume of British capital invested in India, and the considerable share that Britishers have of Indian commerce and industry, it is easy to realise that the problem of double taxation is pretty serious so far as these incomes are concerned. Indeed even so far back as 1898, Sir John Baden-Powell pointed out the evils of double taxation in the House of Commons. [1]

The Bengal Chamber of Commerce addressed a memorial to the Viceroy in 1902 pointing out the hardships they had to endure from double taxation, and submitted that all income which was subject to the payment of the Indian income-tax should, to the extent of that tax, be relieved from the payment of income-tax in England. [2]

The Bombay Chamber accorded their support to the Bengal Chamber and the Madras Chamber followed suit in 1905 ; [3] but apparently nothing was done in the matter. With the rapid and almost world-wide increase of income-tax rates following the War, the problem of double taxation assumed greater importance. The question of double taxation was therefore specially referred to the British Royal Commission on Income-Tax. The Royal Commission appointed from among themselves a special committee to deal with the problem ; they were assisted by representatives from the different Dominions and India. [4] The Committee laid stress on the theory of Imperial Unity, and concluded that relief should be provided equivalent to the lower of the two taxes imposed on the individual. They agreed that the relief should be apportioned on the following basis : firstly, that in respect of incomes taxed both in the United Kingdom and in a Dominion,

[1] Quoted in the Bengal Chamber's Memorial, Appendix, B. C. C. 1902.

[2] Appendix, B, B. C. C. 1902.

[3] p. 8, B. C. C. 1905.

[4] See pp., 168-173, Royal Commission on Income-Tax. The Indian representative was Sir James Meston.

there should be deducted from the appropriate rate of the United Kingdom Income-Tax (including super-tax), the whole of the rate of the Dominion income-tax charged in respect of the same income, subject to the limitation that in no case should the maximum rate of relief given by the United Kingdom exceed one-half of the rate of the United Kingdom income-tax (including super-tax), to which the individual tax-payer might be liable; and secondly, that any further relief necessary in order to confer on the tax-payer relief amounting in all to the lower of the two taxes, should be given by the Dominion concerned. The recommendations of the Royal Commission on this matter were accepted in toto by the British Government and embodied in their Income-Tax Law by section 27 of the Finance Act, 1920.[1] The Indian Government became a party to this arrangement, and their share of the agreement was carried out by means of section 49 of the Indian Income-Tax Act, 1922. This section provides that where any person, who has paid Indian income-tax on any part of his income, proves to the satisfaction of the Income-Tax Officer that he has also paid the United Kingdom income-tax on the same part of his income, and has obtained relief under section 27 of the English Finance Act

[1] "If any person who has paid, by deduction or otherwise, or is liable to pay, United Kingdom Income-Tax in any year of assessment on any part of his income proves to the satisfaction of the Special Commissioners that he has paid Dominion income-tax for that year in respect of the same part of his income, he shall be entitled to relief from 'United Kingdom' income-tax paid or payable by him on that part of his income at a rate thereon to be determined as follows:—(a) If the Dominion rate of tax does not exceed one-half of the appropriate rate of United Kingdom tax, the rate at which relief is to be given shall be the Dominion rate of tax. (b) If any other case the rate at which relief is to be given shall be one-half of the appropriate rate of United Kingdom tax."

"For the purpose of this section, the expression 'The appropriate rate of United Kingdom tax' means the rate at which the claimant for the year to which the claim relates has borne or is liable to bear United Kingdom income-tax and where the claimant is liable to the United Kingdom super-tax a rate equal to the sum of the rates at which he has borne or is liable to bear United Kingdom income-tax and super-tax respectively for that year." F. A. 1920, S. 27, (1)

1920, he should be entitled to a refund of a sum equal to the difference between the Indian rate of tax and the rate at which he has obtained relief from the British Exchequer. The maximum rate of relief thus allowable by India is restricted to one-half of the Indian rate, for example, if an individual has an annual income of Rs. 5 lakhs on which he pays both the British and Indian taxes at the 1926-27 rates, the British tax would work out at 42.51 per cent. and the Indian tax at 26.25 per cent. The British Law grants the individual refund of the Indian tax to the extent of half the British rate or 21.25 per cent. The remaining portion of the Indian tax amounting to 5 per cent. of the income is refunded by the Indian Treasury. In this way, in the final analysis, the individual is taxed only at the higher rate on his total income.

India and the Dominions:—While the same income taxed in both Great Britain and India thus gets the benefit referred to above, there is no similar arrangement with regard to income which may be doubly taxed by India and one or more of the self-governing Dominions[1] of the British Empire. This is not true with reference to all the individuals who come under the operation of such double taxation. The law of New Zealand specifically exempts its citizens from being taxed on income that has already paid tax in any other part of the British Empire; similarly, Canada allows its subjects to deduct from their income-tax, any amount that they may have already paid as income-tax in any other part of the British Empire. Hence Canadians and New Zealanders may enjoy Indian income and yet will not suffer double taxation. In this way nationals of the Dominions who derive Indian income are not subjected to double taxation. It is only Indians, who derive their income from any other part of the British Empire who suffer. Many Indians have an exten-

[1] To this list, Ceylon must be added, an income-tax having been recently promulgated by Ordinance in that colony.

sive trade in South Africa. They have to pay income-tax on it not only to the South African Government but also to the Indian Government. In this way though the income doubly taxed is South African income, the persons who suffer by such double taxation are Indians.

India and Countries outside the Empire :—With regard to income doubly taxed in India and any other country of the world, the position is similar to that at present existing between India and the Dominions, because there are no provisions for relief from double income-tax. Except in some neighbouring Asiatic countries and the Federated Malay States, however, the problem is no more than a theoretical one so far as India is concerned. But in relation to these few countries, the problem does exist. Many Indians derive an appreciable income from the French Indo-China, Saigon, Federated Malay States etc. Dewan Bahadur Rangachariar pleaded for their relief from double taxation in the Legislative Assembly. The Government treated his request sympathetically but no action has been taken so far in the matter.

Conclusion :—Summing up the present position, we may now observe that as regards income doubly taxed by British India and Indian States or by British India and the United Kingdom, the individual is relieved from double income-tax ; his effective payment amounts only to the higher of the two taxes levied upon him. The cost of the relief is, so far as Indian States are concerned, equally shared ; while with regard to United Kingdom, the first charge is on the British exchequer to the extent of one-half of the British rate, the remaining being given by India up to a limit of one-half of the Indian rate. As regards income doubly taxed by British India and one of the Dominions or British India and a foreign country the position is different, there being no allowance whatsoever by way of relief from double income-tax to Indian nationals.

A CRITICAL EXAMINATION OF THE INDIAN POSITION

Let us re-state the Indian position with particular reference to incomes and individuals doubly taxed. As regards relief from double income-tax between British India and Indian States, the income given relief to is clearly Indian in the sense that it arises in India; while the persons given relief are also Indians.[1] This is not the case, however, with reference to the relief from double income-tax between Great Britain and British India. Very few Indians possess income arising in Great Britain, and the amount thus received is by no means considerable. On the other hand, many Englishmen possess income arising in India; even if their number be small, the total amount of income affected is undoubtedly large.[2] This means that 'Indian' income receives relief under the present system, the main personal beneficiaries being Englishmen. As regards British India and the Dominions or British India and the rest of the world, no provision for relief is made by the Indian Government. Indians with incomes from these countries suffer all the rigours of double taxation.

Applying the principles enunciated by us in an earlier section to the preceding brief survey, we may now conclude that the relief given to income doubly taxed by British India and the Indian States is perfectly legitimate, as the beneficiaries are mainly Indians. The financial loss to the state is also not very appreciable, amounting to only Rs. 120,000 in the year 1927-28, the first year for which returns are available.[3]

[1] Foreigners paying both the Indian income-taxes can also claim relief under this system. But this happens rarely in practice, as such foreigners are mostly Englishmen who can obtain relief more easily under Section 27 of the British Finance Act, 1920.

[2] It has been recently estimated by the London Financial Times that the total amount of British capital invested in India comes to nearly £583 millions.

[3] Return No. I-A, All India Income-Tax Report and Returns 1927-28.

The grant of relief to income taxed both in India and the United Kingdom is open to serious objections. In actual practice, there are only a few Indians who benefit by Section 27 of the British Finance Act, while a good number of Englishmen benefit from section 49 of the Indian Income-Tax Act. The income relieved from double taxation is Indian; the persons relieved are not Indians. This is most inconsistent with the true principles of relief from double income-tax, as Indian revenues are spent to relieve the distress of foreigners. Besides, the loss of revenue resulting from this relief shows a steady increase as indicated by the following figures of refunds under section 49.[1]

	In Lakhs of Rs.
1922-23	3
1923-24	41
1924-25	47
1925-26	92
1926-27	106
1927-28	97

The amount of tax thus refunded has more than doubled itself during these years. It should be further remembered that it will continue to grow, for with every fall in the British rate, and every rise in the Indian rate, the burden of relief thrown on the British exchequer (measured by half the British rate) becomes less, while the burden on the Indian Treasury will show a corresponding increase till the maximum of one-half the Indian rate is reached. We may, therefore, conclude that the existing relief given by India to incomes doubly taxed in India and the United Kingdom is undesirable, as the relief accrues mainly to foreigners. It should, therefore, be abolished.

As regards income doubly taxed by India and the Dominions or India and a foreign country, we are not

[1] Compiled from Returns I-A, All India Income-Tax Report and Returns, 1925-26, 1926-27 and 1927-28.

concerned with giving relief to the nationals of other countries who are subjected to Indian taxation. But as we have seen, there are Indians receiving incomes from South Africa, Saigon, French Indo-China, Federated Malay States, etc. who are subjected to double taxation.[1] If the scope of the tax is extended as proposed in Chapter IV, to cover the total income of residents, the hardships of these Indians will be further increased.[2] In this case, it is Indians who suffer from double taxation. This is an unfair handicap which it is the duty of the Indian Government to remove. We have suggested the lines on which relief should be given in such cases in the concluding section of this chapter.

OBJECTIONS TO THE ABOLITION OF THE EXISTING RELIEF BETWEEN INDIA AND THE UNITED KINGDOM

As our proposals involve a great disturbance of the *status quo,* they are likely to provoke the opposition of vested interests. We shall therefore discuss below the objections that may be levelled against them.

The only legitimate ground for objection can be that of economic expediency. It will be said that the consequent double taxation of Britishers may result in preventing the free flow of British capital into India. As a matter of fact, it was asserted by Sir Percy Thompson, a member of the Indian Taxation Enquiry Committee, on the authority of the League of Nations Committee on Double Taxation, the taxation of foreigners will recoil on the head of the borrowing country, and result either in a discouragement of foreign capital or in a higher rate of interest. The force of this contention whatever may be its general truth, is much weakened with reference to India when we remember the following facts.

[1] Vide chapter IV.

[2] The recent Income-Tax Amendment Bill (Bill 32 of 1931) further strengthens our case for relief to such Indians.

(1) Section 27 of the British Finance Act 1920, does not make the grant of relief conditional on reciprocal arrangements by the Dominions. As a matter of fact, with the exception of Australia and British India, the other Dominions have not adopted this particular provision. Hence, even if India does not grant relief, British capitalists will continue to get refunds of the Indian Income-tax paid by them to the maximum extent of one-half the British rate; therefore, the hardship suffered by them will not be to the full extent of the lower (to-day the Indian) tax, but only that portion of it which is in excess of half the British rate. They will not therefore be much discouraged from investing their capital in India.

(2) Even this inconsiderable amount of double taxation will be more than compensated for by the higher profits that British capital can and does realise in India. Many of the jute, tea and banking companies working in India are financed and managed by Britishers; and the rate of interest realised by them in the form of profits is much higher than the market rate. Even if we allow for the slight double taxation referred to above, it is obvious that the profits which British capital can realise in India are greater than what it can realise in the United Kingdom, so that in spite of the extra burden, it will pay them to continue investing in India.

(3) Great Britain has surplus capital which it is difficult for her to invest profitably in her own industries. As has been recently proved in the columns of the London Economist, Great Britain exports a considerable amount of capital annually even to-day. The field for such export is very limited, as next to India come the South American republics. Revolutions are more frequent in South America, and more menacing to foreign capital as they are generally violent. India offers much better security, and will therefore continue to attract British capital in spite of the slight double taxation involved.

(4) British capital already invested in India is very considerable, and no part of it already invested in business is likely to be withdrawn as a result of the abolition of relief from double income-tax. Besides, the very fact that British capitalists have invested large amounts of capital in Indian commerce and industry, compels them to continue adding to the capital reserves of their business concerns. This has to be done, even if the yield is lower than before; otherwise their business will suffer in competition, and in course of time their original capital will disappear. Thus, in spite of double taxation, a part of British capital will, by the very nature of things, continue to be invested in India.

(5) Great Britain has to-day largely lost her pre-war position as the greatest creditor country of the world. The United States of America has become the new capital supplying centre, and Indian requirements of foreign capital may be met as much by America as by the United Kingdom; American capital has this additional advantage that the United States exempts its citizens from "any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States".[1] We may therefore reasonably hope that America will be in a position to supply a good part of India's future requirements of foreign capital.

(6) Finally, even assuming for a moment, that abolition of relief from double income-tax would immediately stop the flow of British capital, we need be in no special fear. India possesses huge reserves of capital,[2] and given a proper banking organisation can meet her own requirements. Besides, it must be remembered that foreign capital creates strong vested interests and claims differential

[1] Section 222 (a) Revenue Act, 1926.

[2] "India possesses a vast store of dormant capital awaiting development and in order to make this available for investment banking facilities must be increased". External Capital Committee Report, p. 15.

(1) Section 27 of the British Finance Act 1920, does not make the grant of relief conditional on reciprocal arrangements by the Dominions. As a matter of fact, with the exception of Australia and British India, the other Dominions have not adopted this particular provision. Hence, even if India does not grant relief, British capitalists will continue to get refunds of the Indian Income-tax paid by them to the maximum extent of one-half the British rate; therefore, the hardship suffered by them will not be to the full extent of the lower (to-day the Indian) tax, but only that portion of it which is in excess of half the British rate. They will not therefore be much discouraged from investing their capital in India.

(2) Even this inconsiderable amount of double taxation will be more than compensated for by the higher profits that British capital can and does realise in India. Many of the jute, tea and banking companies working in India are financed and managed by Britishers; and the rate of interest realised by them in the form of profits is much higher than the market rate. Even if we allow for the slight double taxation referred to above, it is obvious that the profits which British capital can realise in India are greater than what it can realise in the United Kingdom, so that in spite of the extra burden, it will pay them to continue investing in India.

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treatment, and is often a menace to the political advancement of the borrowing country. Recent events in India bear out the truth of these remarks. [1]

To sum up, the removal of the existing relief given by section 49 will not lead to complete double taxation of the Indian income of Britishers. The actual amount of double taxation suffered will be the excess of the Indian rate of tax over half the British rate. This will be more thān made up by the higher yield of profits realised from India. Again, the extensive character of the British capitalists' commitments in India makes necessary further additions to them. Even if the flow of British capital is discouraged, India has enough capital to tide over the situation. Besides, British capital is not such a great blessing when one remembers its reactionary influence on Indian politics. Finally the capital market of the world has shifted to New York, and considering the additional fact that the United States allows its citizens to deduct the amount of foreign income-taxes from the United States tax, it is quite reasonable to expect large amounts of American capital to flow to India. We may therefore dismiss the argument of higher interest on foreign capital and restriction of the flow of British investments.

It may be argued that British companies, though incorporated in the United Kingdom, really have their physical assets in India, and are therefore Indian in character. Consequently, it may be added that relief should be given to them by the Indian Government. This argument is really a plea for the perpetuation of the present relief. If we examine the figures of refund under section 49 we find that more than 95 per cent. of the

[1] Cf. Mr. Chartre's speech at the Annual meeting of Associated Chambers held at Calcutta in December 1928. A similar tendency is visible in the Memorandum submitted by the Association to the Simon Commission.

amount refunded has been given to companies the share of individuals being not more than 5 per cent.[1]

Whatever legal life a company may have, its real life is represented by its shareholders. The doctrine of 'residence' therefore cannot be properly applied to companies. If it is to be applied at all, it should be on the basis that a company is resident at the place where the large majority of its shareholders reside. Tested by this criterion, British companies in India can by no means claim to be Indian residents.

We may therefore conclude that there are no legitimate objections to the abolition on the Indian side of the existing relief from double income-tax between Great Britain and India.

CONCLUSION

As a result of the preceding discussion we have come to the following conclusions :—

1. That no relief should be given by India to income doubly taxed by India and Great Britain.
2. That the present relief given to income doubly taxed by British India and the Indian States is salutory.
3. That the absence of relief to Indians subjected to double taxation on their Dominion and foreign income is unsatisfactory, and therefore provision should be made to relieve them from such double taxation.

It is desirable that all the provisions for relief from double income-tax should be brought together under one

[1] Refunds under Section 49 in lakhs of Rs.

Year	Companies	Individuals	Total
1922-23	3	0.2	3.2
1923-24	33	16.0	49.0
1924-25	42	5.0	47.0
1925-26	84	8.0	92.0
1926-27	101	5.0	106.0

Returns I-A and IV-A, All India Income-Tax Report and Revenue 1925-26 and 1926-27.

separate section in the Income-tax statute; we suggest that section 49 of the Indian Income-Tax Act should be repealed and the following substituted in its place.

"On satisfying the Income-Tax Officer that a part of his income has paid income-tax in a country other than British India, the assessee should be allowed to deduct from the tax payable on that portion of his income the amount already paid as tax abroad, provided the rate of relief thus afforded does not exceed half the Indian rate of tax".

The relief is limited to one-half the Indian rate, because the fact of an individual's *foreign* investment *being foreign* is a *prima facie* evidence of higher profits. Besides, except in Great Britain, the countries from which Indians derive income do not impose very high income-taxes. Companies should be granted relief, only if a majority of their share-holders reside in India and only to the extent of the shares thus held. Rules may be made under the Act for prescribing the mode of obtaining relief.

CHAPTER XII

SOME ADMINISTRATIVE PROBLEMS

As we have already pointed out elsewhere, the importance of administrative machinery in the successful working of any income-tax system cannot be over-emphasized. We have seen that, as a matter of fact, defective administrative machinery was mainly responsible for the failure of the Indian Income-tax during the period 1860-1875. The slow increase in the yield of the tax after its permanent introduction in 1886, brought home to the Government of India the need for improving the administrative machinery even from a strictly financial point of view. The War, however, intervened, and it was not till its close in 1918 that the administrative system was thoroughly overhauled. The old haphazard method of leaving the assessment and collection of the tax in the hands of the already overworked land revenue officials was now replaced by a separate department directly under the Government of India. The immediate result of the change was an increase in the collections; many persons who had hitherto evaded the tax were now brought under its operation. We give below a brief description of the existing administrative machinery.

THE ADMINISTRATIVE MACHINERY

The Central Board of Revenue:—At the head of the income-tax machinery of India is the Central Board of Revenue, corresponding to the Board of Inland Revenue of Great Britain, and created by the Central Board of Revenue Act of 1924. It consists of two civilian mem-

bers and a secretary. The Board does not take any part either in the actual assessment of the tax-payer or in the collection of the tax or even in the hearing and disposal of tax appeals. It is really a superintending body, co-ordinating the activities of the different Provincial Income-Tax Departments, and securing uniformity among their procedure with regard to the assessment and collection of the tax. In matters concerning the principle of the tax, the Board is the supreme guiding body ; thus the percentages of income allowed for depreciation are fixed by them ; as also the computation of mixed incomes such as those of tea companies. They also frame rules for the calculation of 'notional' incomes wherever the real income is not ascertainable, as is largely the case with regard to non-residents. They also fix the mode of assessing certain special tax-payers such as insurance companies. The forms of income-tax returns, of applications for refunds etc. are issued by them and they publish an annual report entitled "The All India Income-Tax Report and Returns" which contains the main income-tax statistics for the year, both central and by provinces—preceded by a brief critical introduction.

Commissioners of Income-Tax:—Below the Central Board of Revenue are the different Commissioners of Income-Tax, who are the heads of the different Provincial Income-Tax Departments. The Commissioners do not take any active part in the assessment of the individual's income. Their functions are largely supervisory. They check the work of the Income-Tax Officers and revise them wherever necessary. Though they do not frame the initial assessment, they can call for the relevant papers and review them, thereby effecting a revision of assessment. As regards the imposition of penalties, they constitute the appellate authority immediately above the Assistant Commissioners. They are also empowered to refer questions concerning income-tax law to the High

Court, either at their own instance or at the instance of the assessee.

Assistant Commissioners :—Below the Commissioner of Income-Tax are the Assistant Commissioners who number more than one in most of the provinces. The Assistant Commissioners act mainly as appellate authorities and hear appeals on questions of assessment, and their decisions are final except when they enhance the assessment. They do not ordinarily take part in the assessment of the tax-payer, though cases are sometimes found in which they act both as assessing and appellate authorities.

Income-Tax Officers :—Next in order of seniority come the Income-Tax Officers who form the real backbone of the system. Assisted by their subordinates, who are known as Deputy Income-Tax Officers in some provinces and Examiners of Accounts in others, these officers carry out the bulk of the assessment in the province. They examine the returns of incomes filed by the assessees; and demand whenever necessary the presence of the assessees in person or by deputy to explain the returns. They scrutinise the accounts of the assessee and other relevant documents, and where these are not a sufficient index of the assessee's income, they institute guarded inquiries into his personal circumstances. Where no information is available they have to assess at discretion under section 23 (a) of the Indian Income-Tax Act. They are thus the vital part of the system, and on them lies the responsibility for framing the assessments. They are also responsible for the timely collection of the tax. Appeals against their judgment lie to the Assistant Commissioners.

CRITICISM OF THE ADMINISTRATIVE MACHINERY

The foregoing description of the administrative machinery clearly shows that the work of assessment as well as

of appeals lies entirely in the hands of officials. From the first stage to the last, the public have no share in the work. This feature of the Indian administrative system has attracted popular attention, and Government have been blamed for not associating non-officials with the official machinery, either in the work of assessment or of appeals. It has been suggested that Boards of Appeal should be created consisting of members elected by tax-payers, to co-operate with the Income-Tax officials in the work of assessment. The question was first raised in the Imperial Legislative Council in 1914. It was again taken up by the Hon. Mr. B. N. Sarma in 1918. In 1921, the Bengal Chamber of Commerce, in their evidence before the All India Income-Tax Committee, pleaded for the creation of a non-official Board of Appeals to which matters of fact could be referred.[1] In 1922, when the present Income-Tax Act was before the Assembly, the Hon'ble Mr. Husseinally moved an amendment to associate non-officials with the officials in the work of assessment.[2] His amendment roused the strong opposition of the representatives of the mercantile community and was subsequently rejected.

This persistent demand for non-official association was based on the following considerations. Firstly, it was claimed that non-officials have full knowledge of local conditions, and their co-operation would ensure a relatively greater accuracy in the assessment. Secondly, such co-operation would command public confidence in the justice of the assessments, and act as a check on the inquisitorial methods of the Income-Tax Officers. Before these premises can be accepted, however, it must be remembered that an effective knowledge of local conditions can be secured only if the non-official assessors were drawn

[1] Vide the evidence of the Chamber before the Taxation Enquiry Committee, T. E. Vol. V, p. 337.

[2] Vide Legislative Assembly Debates, 1922, Vol. II.

from the same class as that of the assessees. Such a procedure will however result in the exposure of the assessees' business secrets to possible rivals in the same trade, and this possibility forms the basis of the fierce opposition of the mercantile community to the introduction of any such scheme.[1] It would also violate one of the cardinal principles of income-tax, viz., that the amount assessed on any individual tax-payer shall remain confidential between the State and the individual tax-payer. It should also be borne in mind that association of non-officials with the work of assessment has been tried in India and found wanting,[2] as the usual tendency for such non-official assessors has been to under-assess the rich and over-assess the poor. The nominal existence of non-official collaboration in assessment which, it is claimed, is a characteristic feature of the British system is not a very powerful argument either, in view of the admission of the British Royal Commission on Income-Tax that really speaking, it is the Inspector of Taxes who does the entire work of assessment.[3] It may be added that this question of non-official collaboration in the work of assessment was made the subject of a special investigation by the Government of India in response to a resolution passed by the Imperial Legislative Council. The results were published in the form of a resolution from which it may be relevent to quote the main conclusion. The resolution runs[4]:

> "The Government of India have received the views of local Governments and administrations on the subject and have found that the proposal has been widely canvassed and unhesitatingly condemned by practically all who were consulted. The general conclusion arrived

[1] The Bombay representatives amongst whom was the Hon'ble Sir Manmohandas Ramji, were most vocal in their protests.

[2] Vide our criticism of the Panchayet and Sialkot systems, chapter II.

[3] Vide Section VI, Part IV, Report of the Royal Commission on Income-Tax.

[4] Quoted in Appendix G, B. C. C. Report 1915.

at is that the creation of formal Advisory Boards would not improve the accuracy of assessment and would tend to make the tax more unpopular''.

In view of the several considerations outlined above, we conclude that, at present, it is not desirable to associate non-officials with the regular official machinery in the work of assessment.

With regard to appeals, however, the position is entirely different. Under the existing Indian law, Income-tax Officers have considerable powers of discretion, and can assess the tax-payer arbitrarily in case he does not submit returns. Complaints have also been made that Income-Tax Officers reject accounts summarily, not because they consider them wholly unacceptable, but just because they contain one or two items which are not permissible deductions.[1] Moreover, under our proposed scheme for the taxation of undistributed corporate profits, the powers of Income-Tax Officers will be enlarged still further. All this points to the need for some authority to whom appeals may lie against the decision of Income-Tax Officers even on matters of fact. In several foreign countries, there exist special appellate authorities not ordinarily connected with the Income-Tax Department to whom appeals lie on matters of fact. For example, there are the American Board of Tax Appeals, the British General Commissioners, and the German Finanzericht and Reichsfinanzhof. It may therefore be accepted as a general principle that appeals should be provided even on questions of fact to an independent authority. The authority generally proposed is the High Court. The Indian High Courts, however, are generally overworked, and are not equipped with that technical knowledge which is necessary for deciding matters of income-tax assessment. Appeals to the High Court would have the addi-

[1] Vide evidence of Lala Sukbir Sinha, Member, Council of State, T. E. C. Vol. III, pp. 401-402.

tional objection of giving undesirable publicity to the tax-payer's personal affairs. It is, therefore, not desirable that appeals on questions of fact should lie to the High Court, and in this conclusion we have the weight of British practice to support us. In the alternative, the other popular proposal is that appeals should lie to some elected representatives of the tax-payers. This proposal is open to the serious objection of the exposure of the assessee's trade secrets to their trade rivals. The best via media between a pure official hierarchy and a democratically elected body of tax-payers would be the creation of Administrative Courts of Justice. These institutions are very popular on the Continent of Europe; and under the new federal regime in Germany, the highest appellate authority on income-tax matters is the Reichsfinanzhof, which is composed of officers of the greatest authority and knowledge in financial matters who enjoy the same independence as judges.[1] We therefore propose that a Central Board of Tax Appeals should be created with power to hear appeals against the decisions of Assistant Commissioners of Income-Tax, and this body should be composed of members who are recruited from expert lawyers, attorneys and accountants. They should be salaried officers, quite independent of the Income-Tax Department. Their decisions must be binding on questions of fact, but not on questions of law, for which the existing provision for appeal to the High Court should be continued. To ensure the confidence of the mercantile community in the honesty of the Board, it may be provided that some of its members shall be selected by Government from a panel consisting of nominees of the different Chambers of Commerce and similar associations. We believe that such a system will create confidence in the minds of the assessees about the validity of their assessment. It may

[1] Vide 'Direct Federal Taxation in Germany and its Administrative Reform':—Manchester Guardian Reconstruction Number, 1922.

also be provided that all proceedings of the Board shall be treated as confidential.

OTHER PROBLEMS

In addition to this principal reform, there are also several minor factors which may be noted. There are a number of incomes to which the principle of deduction at source may profitably be extended, e. g. the interest on treasury bills, pensions and salaries paid by foreign governments or Indian States and received in British India, the annuities other than those paid by Government or private employers, such as annuities under a will or of an insurance company, and interest on debentures issued by firms, associations, clubs or individuals. Interest on mortgages should be charged in the hands of the owner, due provision being made to enable him to shift it on to the lender.

A suggestion has sometimes been made that there should be a standardised form of account according to which the tax-payer should be asked to keep his accounts. This is impossible, especially in a country like India where the assessees are often illiterate, and themselves do not know what their real income is.[1] The Income-Tax Department may, however, issue a standard form of accounts, and tax-payers may be invited to keep their accounts in that form. When this is tried for a few years, it will be then time for us to consider the proposal of making compulsory the keeping of accounts in a standardised form. There is some consolation, however, in the fact that the Indian assessee is gradually getting accustomed to the procedure of the income-tax department, as can be seen from the following table[2]:—

[1] Vide evidence of Messrs. Gimson and Gaskell—Commissioners of Income-Tax, Vols. III and V. T. E. pages 384 and 55 respectively.

[2] Compiled from Return VIII, Central Board of Revenue Reports, 1924-26.

Years	Percentage of accounts produced to accounts demanded	Percentage of accounts submitted on which assessment could be based
1924-25	71·8	60·3
1925-26	73·1	61·2
1926-27	76·2	64·9

We do not propose to give a description of the various methods by which fraudulent tax-payers evade their tax payments. We may point out however that evasion of tax is the worst form of theft, resulting in an increased taxation of other people. The only way to check evasion is, apart from the growth of administrative efficiency, the creation of a sound public opinion, which would condemn such practices without reservation.

SUMMARY

1. Non-officials should not be associated with the official machinery so far as assessment is concerned. But appeals on matters of fact should be heard by a specially constituted Court of Administrative Justice to be called the Central Board of Tax Appeals.

2. The principle of taxation at source should be extended to several other sources of income.

3. It is not advisable to make compulsory a standardised form of accounts, but the experience of the last three years shows that a relatively larger number of persons submit accounts, and out of these an increasing percentage are assessed on the basis of their accounts.

4. The only way to deal with fraudulent tax-payers is, apart from increase in the efficiency of the administrative machinery, to have a healthy public opinion.

CHAPTER XIII

Economic Condition as Reflected in Income-Tax Statistics

The utility of income-tax statistics of any country in the analysis of the economic conditions of its people is universally admitted.[1] It is therefore appropriate that in a work which attempts a scientific study of the Indian Income-Tax, there should be a chapter devoted to an analysis of available statistics in order to throw some light on the economic conditions of the people. For example, we may try to ascertain the general historic trend in the national income, both in the aggregate and per capita. We may also analyse its distribution and trace tendencies. We may then discuss the figures of income-tax collections from the point of view of sources, and finally attempt a classification of the different provinces in terms of economic prosperity as seen through income-tax statistics. We shall divide this chapter into the following four sections :—

(1) Growth of the number of income-tax-payers and their total income.
(2) Distribution of income among income-tax-payers.
(3) Income-tax statistics classified by sources.
(4) Income-tax statistics classified by Provinces.

Before entering into a detailed discussion of the four topics mentioned above, we must mention certain considerations of a general nature concerning the available statistics. As our object is primarily a comparison of real values over a long period of years, we have to re-shape the income-tax statistics and use them subject to certain modifications.

The first fact to be noticed is the relative inaccuracy of

[1] Sir J. C. Stamp's "British Incomes and Prosperity" is a work almost entirely devoted to such a treatment of British income-tax statistics.

the statistics, due partly to an inefficient administrative machinery, and partly to an easy conscience on the part of some of the tax-payers. This problem of evasion exists everywhere, and it is difficult to give it accurate statistical recognition. Under normal circumstances, an income-tax machinery grows in efficiency with time and accounts for a part of the increase in collections, thereby vitiating a real comparison of economic conditions between the two periods. This difficulty did not arise in India till after 1919, for, prior to that, the land revenue officials administered income-tax and their efficiency never showed an appreciable increase. It was only after 1919, when special income-tax departments were created for all the provinces, that evasion became difficult ; the large number of new assessees discovered after this year are obviously persons who had hitherto been evading the tax. We shall again refer to this fact in a subsequent section of this chapter.

The second point to be borne in mind is the steady fall in the value of money that has been taking place in India—in common with the rest of the world—for the last forty years. For example, the prices of commodities have increased enormously during the last forty years, with a consequent decrease in the real value of money. For purposes of analysis and comparison, therefore, we cannot take the nominal increase in the figures of tax collections and taxable income as evidence of real income. The nominal figures will have to be weighted by a regular price index more especially if they are to be used as indices of changes in economic conditions. This will ensure equality in the real value of every rupee of the tax collected, and of the amount of income assessed in every one of these years. Corresponding to this is the population index number, which must be used when considering the question of a real increase in the number of tax-payers.

The third point to be noted is that the figures of assessees, collections, and taxable income given below all relate to persons with annual incomes of and exceeding Rs. 2,000. It is true that in 1886, persons with incomes of and exceeding Rs. 500 were charged to income-tax; the taxable minimum however, was raised to Rs. 1000 in 1903 and subsequently to Rs. 2,000 in 1919. It is obviously impossible to make any intelligible comparison, if figures relating to assessees with incomes below Rs. 2,000 are taken for the years prior to 1919. Hence the figures dealt with relate only to assessees with incomes of and exceeding Rs. 2,000.

Finally, it may be pointed out that only summary figures are used in the body of this chapter. For detailed statistics, the reader's attention is drawn to the Appendix XII.

GROWTH OF THE NUMBER OF INCOME-TAX-PAYERS AND THEIR TOTAL INCOME

The following table sets forth quinquennial averages of the number of assessees, their gross taxable income and the average income per assessee for the last 40 years[1]:—

Table No. I.

Period (financial years)	Number of assessees	Gross taxable income in lakhs of Rs.	Income per assessee Rs.
1886-1890	43,052	35,62	6519
1891-1895	61,512	41,82	6832
1896-1900	69,285	47,72	6794
1901-1905	77,837	54,09	6949
1906-1910	92,576	68,52	7401
1911-1915	1,11,617	85,67	7655
1916-1919[2]	1,58,706	1,36,53	8427
1922-1926	2,91,146	2,21,28	7824

[1] For details, Vide Table I, Appendix XII.

[2] Owing to reorganization of the administrative machinery, the Income-Tax Provincial Reports do not contain the required figures for the

Number of assessees :—The table reveals an uniformly steady increase with few jumps in the number of assessees for the six quinquennial periods following 1886 ; between 1916 and 1919, however, there is a sharp rise, the number of assessees increasing by more than 40 per cent. The post-war quinquennial period shows an even more arresting growth, the assessees increasing by about 100 per cent. over their number during the War period. Compared with the figures for the first period, (1886-90), the number of assessees in the final period (1922-26) has increased by about 600 per cent. The obvious inference would be that there is a remarkable growth of prosperity in India and that well-to-do people are rapidly increasing in number. This obvious conclusion, however, has to be greatly modified in the light of the following facts :—

(1) The real value of a monetary income of Rs. 2,000 to-day is much less than what it was either in the period 1886-90 or the period 1911-15. The average weighted index number[1] of prices was 110 for 1886-1890 and 261 for the years 1922-26 ; if we can express the money incomes of 1922-26 in terms of the money incomes of 1886-90, we may say that an income of Rs. 843 in 1886-90 meant much the same thing as an income of Rs. 2,000 means to-day. If we make an allowance for the fact that the index number used by us is not a chain index number, and that its base is as distant as 1873—when some items might have been included which are now unimportant and some items might have been excluded which are now important—we may roughly assume that an income of Rs. 1,000 in 1886-90 meant the same real income in terms of

years 1920-21. They are not published in any Government Report. Efforts were made to obtain these figures from the Central Board of Revenue, but the Board could not see their way to grant our request. Hence the period 1916-17 to 1919-20 contains only 4 years and is not a quinquennial period.

[1] The period index numbers used throughout this chapter are the Government of India weighted index Nos. taken from Index numbers of Indian prices 1861-1926.

purchasing power as an income of Rs. 2,000 does in 1922-26. Therefore, if there is to be any real comparison between the number of tax-payers in 1886-90 and 1922-26, we must add to the former figure the number of assessees whose income were or exceeded Rs. 1,000. This revised figure comes roughly to about 1,38,000 ;[1] comparing this to the 221 thousand assessees of 1922-26, we find that the real increase of persons whose purchasing power equals to and is above Rs. 2,000 of to-day, comes only to 60 per cent., and not 600 per cent. as may appear at first sight from Table I. In other words, during the course of 40 years, Indian residents whose real incomes were equal to a nominal income of Rs. 2,000 to-day, have increased in number, by 60 per cent. only.

This figure of 60 per cent. will have to be further corrected in the light of the increase in population ; otherwise there can be no real comparison. In 1886-90, there were 627 tax-payers out of every ten lakhs of population as against 895 in 1922-26. The increase is therefore only 43 per cent.

A part of even this increase must be due to the growth of administrative efficiency which made evasion difficult and increased the number of tax-payers, especially after 1919. The Provincial Income-Tax Reports of the years 1919-22 speak enthusiastically of such increases.[2] Allow-

[1] The actual figures are :—

	Assessees with incomes of and over Rs. 1,000
1886-87	1,17,547
1887-88	1,34,741
1888-89	1,41,199
1889-90	1,46,574
1890-91	1,49,759
Average	1,38,104

Compiled from statistics of British India, Finance and Revenue, 1911-12, Vol. IV B.

[2] Cf. Many assessees whose incomes were below Rs. 2,000 are now included in the category of persons with incomes of Rs. 2,000 and over. The change is in part due to better methods of assessment.

"Scores of instances can be quoted showing how the special town surveys by these agencies led to the discovery of assessees who had

ance will have to be made for this factor, if we want to consider the real increase during the last forty years, of persons whose annual purchasing power equals Rs. 2,000 of the present day.

It is difficult to allow accurately for this factor, but we shall not be wrong if we assume that 10 per cent. of the increase during the period 1886-1926 is due to administrative efficiency. This figure comes to 830, and will have to be added to the 1,38,000 who were actually paying the tax in 1886-90. The real increase therefore is from 632 out of ten lakhs of population in 1886-90 to 895 in 1922-26, or of 42 per cent.

We summarise below our conclusions regarding the real increase in the number of income-tax payers.

Table No. II.

Nominal increase	576
Increase as weighted by the index number of prices ...	60
Increase as corrected by the price as well as population index number	43
Increase as corrected by the price and population index numbers as well as after making an allowance for administrative efficiency or the Real Increase ...	42

hitherto escaped notice".—Punjab Annual Report 1919-20; for some provinces the figures of increase under assessees are not available, but they may be gauged to some extent by the rapid increase in collections owing to the new machinery.

Commenting on the rapid increase of tax collected in Rangoon, the Financial Commissioner wrote "The increase in Rangoon (of Rs. 18 lakhs) is almost entirely due to the more efficient working of the office".—Burma Annual Report, 1918-19.

Also cf. The Financial Commissioner's comment on the rapid increase of revenue during the years 1919-20 to 1922-23. "Speaking generally, this enormous growth of income-tax revenue is partly due to the general improvement in the machinery of administration".—C. P. Annual Report, 1922-23.

In the Punjab, owing to the appointment of special officers the assessment increased by the following percentage:—

Ambala 77 per cent.; Jullundar 71 per cent.; Lahore, 58 per cent.; Rawalpindi 56 per cent.; Multan 77 per cent.;—Punjab Annual Report, 1919-20.

Commenting on the rapid increase of revenue in Bombay, the Income-Tax Report remarks "The increase is not entirely due to the greater prosperity of trade and industry, other factors contributing to the rise are...the improvement of the procedure and of the machinery for assessing and collecting the tax". Bombay Triennial Report, 1917-20.

As noticed above, the number of assessees per every ten lakhs of population amounted during the period 1922-26 to 895; in other words, hardly one out of every 1000 persons in India have 'incomes' of or exceeding Rs. 2,000 a year. It is, of course, true that we have not made any statistical allowance for persons who may still be evading the tax. Even if we assume in a most extravagant manner, that for every individual who pays the tax, one person evades it the grim fact of Indian poverty cannot be lightly brushed aside; because this will mean that 998 persons out of every 1000 have incomes below Rs. 2000, and Rs. 2,000 is certainly not wealth but just ensures sufficiency for a family of four persons. It is pointed out by those who ardently believe in the unmixed blessings of British rule that the income-tax statistics are misleading, as they do not include agriculture, the great Indian industry which maintains more than 70 per cent. of our population. We have already seen that only a few agriculturists have incomes exceeding Rs. 2,000, and even among these, the major part of their income is concentrated in a few hands. The Statutory Commission of 1930 estimates a probable yield of Rs. five crores from the taxation of agricultural incomes;[1] this is less than 30 per cent. of the amount realised in 1926 by the taxation of only industrial, commercial and salaried incomes. It is clear, therefore, that the exclusion of agriculture from income-tax statistics does not vitally alter their character as an index of general economic condition, or the appalling poverty of the masses of the people.

We have to conclude from an analysis of the growth of the number income-tax-payers that India is a dreadfully poor country, in which there are only a few well-to-do persons, and that the rate of their increase is painfully slow.

[1] Vol. II, Recommendations, p. 257.

Gross taxable income and Income per Assessee:—Column 3 of Table I gives figures of gross taxable income which apparently shows an enormous increase. If we correct the figures according to changes in the price level, we get the following results :—

Table No. III.

Period (financial years)	Nominal Income (in lakhs of Rs.)	Income as corrected by the Quinquennial average of weighted index numbers (in lakhs of Rs.) of prices
1886-1890	35,62	35,62
1891-1895	41,83	37.40
1896-1900	47,08	38,93
1901-1905	54.10	46.13
1906-1910	65.82	46,24
1911-1915	85.67	53,54
1916-1919	136,53	61,27
1922-1926	221,28	84,78

There is an increase of nearly Rs. 50 crores during the period. If these figures are used as an index of the growth of economic prosperity in the country, we should take account of the fact that the figures for the last period include the incomes of those whose incomes were equal to only Rs. 1000 in 1886-1890. We will also have to make an allowance for the amount of income taxed in 1922-26, which had evaded such taxation in 1886-90. If we make allowance for both these factors, we find that the taxable income of comparable tax-paying classes in India increased from Rs. 47,12 lakhs in 1886-90 to Rs. 84,78 lakhs in 1922-26; in other words, taxable income in the final period showed an increase of 80 per cent. over that in the first period. Even these figures, however, give us no valid ground for drawing conclusions regarding economic progress, as it is the average income or the income per capita which is a real index of economic conditions. This

latter figure is, as corrected by population index numbers, Rs. 3,394 in 1886-90 as against Rs. 2,928 in 1922-26.

Conclusion :—We can now summarise the results of our enquiry into the growth of the number of income-tax-payers and their taxable income. The following table gives the index numbers of such increases :—

Table No. IV.

Description	1886-90	1922-26
Number of Assessees	100	142
Amount of Taxable Income	100	180
Income per Assessee	100	88

The figures given in the preceding table are a sufficient commentary on the economic condition of this nation during the last forty years. The income per head shows an actual decrease, while the number of assessees shows an increase which is remarkably small as compared with the length of the period over which it has taken place. Among the income-tax-payers of India, then, there is a phenomenon akin to overpopulation, the sharers of the income increasing faster than the amount shared per head.[1]

DISTRIBUTION OF INCOME AMONG INCOME-TAX-PAYERS

The following table gives the percentage which the assessees in different income grades bear to the total number.[2] The figures are for quinquennial periods.

[1] We do welcome an increase in the number of well-to-do persons, but there would have been economic progress of a more notable character if such increase had been accompanied by an increase in the income per head as well.

[2] See Appendix XII for the actual figures of assessees in the different income grades for these years.

Table No. V.

PERCENTAGE OF ASSESSEES IN DIFFERENT INCOME GRADES TO TOTAL NO. OF ASSESSEES.

Period (financial years)	Rs. 2000-4999	Rs. 5000-9999	Rs. 10000-19999	Rs. 20000-29999	Rs. 30000-39999	Rs. 40000-49999	Rs. 50000 and above
1886-1890	69·11	19·00	7·82	2· 0	·79	·39	·87
1891-1895	68·91	19·02	8·22	1·98	·85	·39	·83
1896-1900	70·95	16·76	8·18	2·02	·80	·40	·80
1901-1905	68·98	19·26	7·94	1·92	·72	·37	·83
1906-1910	68·90	19·48	7·85	1·93	·74	·36	·94
1911-1915	68·08	20·26	7·85	1·83	·70	·36	·92
1916-1919	65·26	21·57	8·42	2·31	·75	·41	1·28
1922-1926	64·36	21·55	9·46	2·41	·88	·47	·87

Assessees in different Income-grades—their relative distribution :—The main fact that emerges from the preceding table is the sharp change which has taken place in the relative distribution as between the 30 years preceding 1916 and the 10 years following it. In the former period, the number of assessees in each income grade bears a more or less constant proportion to the total number.[1] For instance, assessees with incomes between Rs. 2,000 and Rs. 5,000 formed 69 per cent. of the total number, while assessees with income between Rs. 5,000 and Rs. 10,000 kept somewhere about 19 per cent. ; similarly, assessees with incomes between Rs. 20,000 and Rs. 30,000 formed about 2 per cent. of the total, while the other grades also remained stationary.

It is only after the year 1915, following the outbreak of the War, that there began to take place a definite change in the distribution of assessees in the different grades. The persons whose incomes were between Rs.

[1] We have not taken note of the changes in the value of money during these years because they equally affect all income grades and it is the proportion of their distribution in which we are interested.

2,000 and Rs. 4,999 fell down from 69·11 per cent. to 64·36 per cent. during 1922-26; those with incomes between Rs. 5,000 and Rs. 9,999 showed an increase, rising from 19 per cent. during 1910-11 to 21·55 per cent. during 1922-26. Persons whose incomes were between Rs. 10,000 and Rs. 19,999 show a sudden rise from 7·82 per cent. in 1915 to 9·46 per cent. during 1922-26. The increase in this class is undoubtedly appreciable. Persons with incomes between Rs. 20,000 and Rs. 29,999 were decreasing in the period prior to 1916 but show a sudden rise in the recent years, reaching 2·41 per cent. during 1922-26 as contrasted with 1·83 per cent. during 1911-16. In this case also, the increase is appreciable. Persons with incomes between Rs. 30,000 and Rs. 39,999 after having shown a similar tendency to fall in the years before 1916, show a steady rise during the next 10 years reaching ·88 per cent. during 1922-26. Persons with incomes between Rs. 40,000 and Rs. 49,999 remain steady or slightly decrease in their proportion during the early period; in recent years they increased and reached ·47 per cent. during 1922-26, as contrasted with ·39 per cent. during 1911-16. Persons with income of Rs. 50,000 and over grow steadily throughout the period, except during the final years of the period, 1922-26. After 1916-19, there was a sharp fall in the percentage of these persons from 1·28 to ·87. It may be pointed out that the actual number of these millonaires does show an increase from 1628 to 1464, though there is a decrease in its percentage to the total number of assessees. This latter fact, however, is easily explained by the great increase in the total number of assessees which took place during the period 1922-26.

Assessees in different Income grades—figures of absolute increase:—We shall now consider the absolute increase in each of those grades, and then compare the rates of such increase. The following table gives quin-

quennial figures of the index number of increase in each of these grades for the years 1886-1926.

Table No. VI.

ASSESSEES IN INCOME GRADES AND THE INDEX NUMBER OF THE INCREASE IN THEIR NUMBER

Period (financial years)	Persons having their income between						
	Rs. 2000 and Rs. 4999	Rs. 5000 and Rs. 9999	Rs. 10,000 and Rs. 19,999	Rs. 20,000 and Rs. 29,999	Rs. 30,000 and Rs. 39,999	Rs. 40,000 and Rs. 49,999	Rs. 50,000 and above
1886-1890	100	100	100	100	100	100	100
1891-1895	116	117	120	115	126	122	114
1896-1900	131	113	134	128	129	136	131
1901-1905	148	150	150	141	136	144	143
1906-1910	175	180	176	168	165	168	193
1911-1915	209	226	213	193	186	206	229
1916-1919[1]	227	273	259	277	228	262	360
1922-1926	502	612	652	648	600	670	546

Taking these grades one by one and arranging them in the order of their increase, we get the following results :—

Table No. VII.

	1886-90	1922-26
Persons with incomes between Rs. 40.000 and 50,000	100	670
Persons with incomes between Rs. 10,000 and 19,999	100	652
Persons with incomes between Rs. 20,000 and 29,999	100	648
Persons with incomes between Rs. 5,000 and 9,999	100	612
Persons with incomes between Rs. 30,000 and 39,999	100	600
Persons with incomes of Rs. 50,000 and upwards	100	546
Persons with incomes between Rs. 2000 and 4,999...	100	502

[1] As we have already observed, no figures are available for the years 1919-20 and 1920-21.

Conclusion:—The figures of absolute increase in the number of income-tax payers taken side by side with the increase in their proportion to the total assessees shows a definite tendency in their distribution. Persons with incomes between Rs. 2,000 and Rs. 5,000 decreased from 69·11 per cent. of the total to 64·36 per cent., incomes in the highest grade remaining constant at ·87[1] per cent. Thus the lowest grade, while showing the least 'absolute' increase, actually decreases in relation to the total number. The assessees in the highest grade, while showing the next least 'absolute' increase, remains relatively constant. Intermediate grades, however, generally show an increase both absolutely, and relatively to the total number. If we assume for a moment that persons in the lowest grade are poor, (poor in a relative sense), that persons in the intermediate grades are the middle classes, and that persons in the highest grade are richer classes, we may then assert that the prevalent tendency is for a decrease in both the poor and the rich classes, and an increase in the middle classes. It is, of course, not true to say that Rs. 2,000 represents poverty; but our conclusions are correct at least with regard to income-tax paying persons. If equal distribution of wealth is a worthy ideal, then we may say that the greater increase in the middle classes shows that Indian conditions slightly tend towards the realisation of that ideal so far as persons with incomes above Rs. 2,000 are concerned.

[1] Vide Table IV of this chapter.

INCOME-TAX STATISTICS CLASSIFIED BY SOURCES

The following table gives the relevant figures :—

Table No. VIII.

QUINQUENNIAL FIGURES OF PERCENTAGE OF TOTAL TAX CONTRIBUTED BY SOURCES.

Period (financial years)	Salaries	Securities	Property	Business	Professional Sources earnings	Other sources
1886-1890	29·7	5·8	3·5	55·5	4·3	...
1891-1895	29·6	5·5	4·1	55·9	4·4	...
1896-1900	29·1	5·0	4·2	57·0	4·4	...
1901-1905	29·0	5·1	4·3	56·1	4·2	1·3
1906-1910	28·5	5·0	4·7	56·6	4·0	1·2
1911-1915	27·8	5·0	5·3	56·2	4·4	1·3
1916-1919	20·2	6·1	4·6	63·9	3·3	1·9
1922-1926	20·8	5·0	4·7	63·5	2·3	3·0

Income-Tax Collections by Sources—Historical :— Analysing these figures historically, we can trace two distinctly perceptible tendencies. Firstly, the proportion of the tax contributed by 'salaries and pensions' to the total amount collected shows a steadily decreasing percentage. From about 29·6 per cent. which they occupied during the first two quinquennial periods (1886-1895), they have fallen to 20·8 per cent. during the period 1922-26. Secondly, in direct contrast to salaries, the amount of tax contributed by 'business' shows a steadily increasing percentage, rising from 55·5 during 1886-1890 to 63·5 during 1922-26. The percentage contributed by 'securities' does not show any appreciable variation, but we may generally say that it shows a slight decrease during the whole period. The tax realised from house property shows an increase, but in a vacillating manner, hav-

ing fallen after 1913; that from professional earnings shows a relative decrease.

The decrease in 'salaries' is mainly explained by the rapid growth of the total collections and, especially, those from business. This latter increase is an index of the gradual industrialization of the country that is now taking place, while the fluctuations in the tax collected from income of house property seems to indicate a relative under-assessment in their case. The decrease in the tax from professional earnings is explained in a manner similar to that in 'salaries'; both these heads of income had obtained full representation in 1886-90 while business incomes grew much more rapidly after that period, thereby decreasing the former's relative importance.

Income-Tax Collections by Sources—recent position:—The following table gives the percentage of the total tax contributed by these different sources of income during the period, 1922-26.

Table No. IX.

Source of Income	Percentage Contribution
Business	63·5
Salaries	20·8
Securities	5·0
Property	4·7
Professional earnings ...	2·3
Other sources	3·7

Business and salaries jointly contribute more than 84 per cent. of the total tax, as against the 10 per cent. yielded by securities and house property. If the former two can be classed as 'earned' income, then 'unearned' income plays only a small part; and this is, as it should be, from the point of view of economic democracy. The obvious importance of industry and commerce is seen even more

clearly if we add to the 63·5 per cent. directly contributed by it another 10 per cent. as its share in income under 'salaries'. While this indicates the extreme dependence of the income-tax on industry and commerce from the fiscal point of view, it is no sign of rapid industrial development. The percentage share of business in the taxable income may be high, but the taxable income itself is low and shows but a gradual rise. Taken in conjunction with this fact, the income-tax figures clearly prove the gradualness of the industrial progress of this country.

INCOME-TAX STATISTICS CLASSIFIED BY PROVINCES

The following table reveals the number of assessees per 1,00,000 and the tax paid per head of the population in the different provinces during the year 1926-27 :—

Table No. X.

Provinces	Assessees for 1,00,000	Tax per head of population Rs. As. Ps.
Bombay	348	1—13— 3
Bengal	90	1— 3— 9
Madras	90	0— 5— 4
U. P.	52	0— 2—10
Punjab	124	0— 5— 6
Burma	194	1— 9— 7
Bihar and Orissa	41	0— 2— 0
C. P. and Berar	96	0— 4— 7
Assam	73	0— 8— 8

The figures of tax per head given in column 3 of the preceding table represent the taxable income of the provinces, while the figures of assessees given in column 2 represent the number of taxable persons resident in the particular provinces : It has to be decided, however, as to which of these would more correctly represent the economic status of the provinces. Obviously the figures of

tax per head are not the correct criterion, for the income of 'companies' swells the taxable income, increases collections and thereby raises the incidence per head for the province, though the shareholders may be resident all over India. Two specific instances are the provinces of Burma and Bengal with the high incidence of Rs. 1-9-7 and Rs. 1-3-9 respectively arising mainly from the taxation of jute, coal and oil companies operating within their limits.[1] As we cannot arbitrarily equate the companies into persons and as we can get no information as to their residence, we shall use only the figures of assessees as an index of the economic status of the different provinces. If we arrange the provinces in order of prosperity, we get the following result :—

Table No. XI.

Provinces	Income-tax payer per 1,00,000 of the population
Bombay	348
Burma	194
Punjab	124
C. P. and Berar	96
Madras	90
Bengal	90
Assam	73
U. P.	52
Bihar and Orissa	41

[1] The importance of this factor in vitiating the value of the figures of incidence per head of the population can be seen from the following table :—

	Income-Tax collections from companies (in lakhs of Rs.)
Madras	23
Bombay	52
Bengal	172
U. P.	17
Punjab	6
Burma	75
Bihar and Orissa	0.5
C. P.	7
Assam	16

The number of assessees is, however, not a conclusive evidence of prosperity. A province with a lower proportionate number of assessees might have more super-tax payers than one with a larger proportionate number of income-tax paying assessees. The following table gives the order of economic prosperity from the point of view of super-tax payers only :—

Table No. XII.

Province	Percentage of super-tax payers resident in each Province to the total number
Bombay	30·32
Bengal	22·77
Burma	17·02
Madras	12·39
Punjab	6·33
U. P.	4·19
Bihar and Orissa	3·81
C. P. and Berar	2·39
Assam	0·85

This order differs from the one arrived at from the general figures of income-tax payers. Before stating our final conclusions, however, we may also examine the percentage share of each province in the income-tax collections under each source. We omit 'salaries' from this review, as collections under this head in every province do not entirely represent the share of each, owing to existence of 'salary circles', and the accompanying deduction of tax at source by the Accountant General. The following table sums up the percentage share of each province in the total income-tax collections from different sources of income :—

Table No. XIII.

Province	Percentage share in income-tax collection from			
	Business	Securities	House Property	Professional Earnings
Bengal	31·0	13·6	23·6	20·1
Bombay	19·5	46·8	38·7	29·9
Burma	17·8	2·3	9·5	7·9
Madras	10·8	3·4	7·0	11·8
Punjab	5·2	3·1	7·7	8·7
U. P.	4·9	2·4	5·1	9·7
C. P. and Berar	3·4	0·3	2·1	3·3
Bihar and Orissa	3·0	0·5	2·3	6·5
Assam	2·5	0·07	0·3	0·7

CONCLUSION

The following are the results of the preceding tabulation and analysis of provincial income-tax statistics which enable us to determine the relative economic prosperity of the different provinces.

(1) With the exception of the tax contributed by business incomes, Bombay heads the list. She has got the largest number of income-tax paying persons per one lakh of population ; at the same time she has the highest percentage of persons with incomes above Rs. 50,000. That she is the largest investing province of India is clearly proved by the fact that almost 50 per cent. of the income-tax on securities was realised from Bombay. In property income as well as professional earnings, she gives the largest share of the total Indian collections. It is only in business that she is surpassed by Bengal ; this fact being explained by the greater development of joint-stock enterprise in that province.

(2) Apparently, Bengal comes next in order of economic prosperity because she heads the list of provinces in Income-tax collections under business, and comes next to

Bombay in the percentage of collections under property, securities and professional earnings. Next to Bombay, she has the largest percentage of persons with incomes above Rs. 50,000, but she has only 90 assessees per 1,00,000 of population as contrasted with 194 of Burma, and 124 of the Punjab, and 96 of C. P. and Berar. This means that Bengal, though more developed than other provinces industrially and commercially, is on the whole poorer than Burma and Punjab. It may also be noted that her taxable income is concentrated in fewer hands so that she has a larger number of millionaires.

(3) Next comes Burma with 194 assessees per 1,00,000 of population. In this, Burma is next only to Bombay. She has also a good proportion of millionaires with 17 per cent. of the total number for the whole country. She is also well developed from the point of view of business and property income, coming next to Bombay and Bengal. Indeed, looking to the fact that she has more well-to-do people as compared to her population than Bengal, and also remembering that economic status is essentially linked with individuals, we must place Burma next to Bombay in the matter of economic prosperity.

(4) It is very difficult to choose between Madras and the Punjab for the next place. It is true that the Punjab has more well-to-do people as compared to her population, but Madras has a higher percentage of millionaires and a greater share of income from business, securities and professional earnings, while the Punjab has a slightly greater share of property income. Weighing these factors together, we submit that both Madras and the Punjab should be put in the fourth place with the odds slightly in favour of the Punjab.

(5) It is very difficult, too, to arrange the other provinces in a correct order of economic prosperity. While the Central Provinces and Assam have more well-to-do people as compared with their population, the United Provinces

and Bihar and Orissa have more millionaires. Further, the United Provinces has a greater share of income from business, securities and professional earnings. We may therefore roughly say that the United Provinces , and the Central Provinces and Berar, are on an equal level, with the balance slightly in favour of the Central Provinces. As regards Bihar and Orissa and Assam, we will place Assam higher than Bihar and Orissa, as she has more well-to-do people in relation to her population.

If we arrange the provinces according to their relative economic prosperity we get the following result :—

(1) Bombay
(2) Burma
(3) Bengal
(4) Punjab and Madras
(5) Central Provinces and United Provinces
(6) Assam
(7) Bihar and Orissa.

CHAPTER XIV

CONCLUSION

During the course of the preceding chapters, we have first traced briefly the history of the Indian income-tax, and then have discussed its provisions in detail from the standpoint of economic principles as illustrated and modified by their practical application abroad. Our analysis of the Indian system both historically and as it exists at present, reveals an entire absence of any background of theory or principle. From start to finish, the Indian income-tax savours of considerations of expediency. It was introduced in 1886 to meet a pressing demand for additional revenues ; similar reasons prompted the introduction of progressive rates in 1916 and that of a new administrative machinery in 1918. An unfortunate decision of the Madras High Court necessitated a revision of income-tax statute in 1922 and led to the passing of the Indian Income-Tax Act of that year. Since then, every year has seen the incorporation of at least two or three amendments to the law, introduced according as particular circumstances demanded. At no time in the history of the Indian income-tax has any attempt been made by Government to examine the fundamental principles underlying its levy or to analyse its incidence ; such improvements as have been made from time to time are of a piecemeal character, and do not show that well-thought out policy, which one would normally expect to be the basis of an income-tax imposed by a civilized government. In other words, in regard to the Indian income-tax, Government has followed a policy of drift, allowing the system to be altered according to the needs and circumstances of

the moment, without reference to the reactions of each such change on the other parts of the system. The income-tax system of this country is, therefore, a curious medley of conflicting provisions, which fail to stand the test of modern income-tax theory, and the practice of foreign countries.

Our detailed examination of the Indian income-tax has enabled us to suggest a series of changes which, if adopted, would so alter our system as to place it on a scientific basis, and make it conform to modern principles of income-taxation. The chief criterion we adopted for this examination is the doctrine of ability to pay as enunciated and elaborated by Sir J. C. Stamp in his "Fundamental Principles of Taxation". This theoretical test has been supplemented by reference to foreign practice. Considerations of national benefit and the larger interests of the country have also been taken into account in framing proposals for the reform of the Indian income-tax system. We may now briefly review the chief results of our investigations.

The scope of the Indian income-tax is vague, ill-defined and unreasonably narrow in several respects. For example, some incomes arising in the country, such as interest on sterling securities and pensions payable abroad, are exempted from the income-tax ; at the same time, others received in the country such as incomes from all sources received from abroad three years after their first acquisition, are also allowed to be enjoyed untaxed. There seems to be a great confusion of thought underlying the present scope of the tax, the two concepts of 'origin' and 'residence' existing in a mutilated form, supplemented by an ingeniously convenient concept of receivability. We have therefore recommended that such an unsatisfactory state of affairs should be terminated at once, and the scope of the tax so extended as to include all incomes arising or received or receivable in this country without any am-

biguity. This recommendation is contingent upon suitable provision being made for relief from double income-tax to Indian sufferers.

As regards the existing exemption of agricultural incomes, it has been pointed out that such a course is justifiable only if and so far as the incidence of land revenue is the same as that of the income-tax. But land revenue does not fulfil the tests of the income-tax. It gives no exemptions, and its rate is uniform irrespective of the size of the income, so that its incidence is actually regressive. The evil is much worse in the case of the permanently settled estates, where the land revenue partakes of the nature of a purchase-price and leaves untaxed a vast amount of unearned increment. The proper solution would be an immediate removal of the exemption of agricultural incomes, accompanied by a simultaneous abolition of the land revenue paid by temporarily-settled estates and holdings. Such a procedure may not be immediately practicable on grounds of the loss of revenue involved thereby. It is therefore suggested by way of a compromise, that while permanently settled zemindari incomes should pay the full income-tax in addition to land revenue, the temporarily-settled agricultural incomes should pay only that amount of income-tax, which is necessary to supplement the incidence of the land revenue to bring it on a level with the incidence of the income-tax on non-agricultural incomes.

The present Indian system fails to distinguish clearly between gross and net income. For example, certain essential items of expenditure such as depreciation allowances on rented buildings, and obsolescence allowances on intangible capital are not allowed as deductible items from the assessable income. Besides, losses are not allowed to be carried forward against future profits with the result that where the income of the business fluctuates between profit and loss, the tax tends to fall on capital. We have,

therefore, recommended certain changes that will make "net" income the basis of assessment, the most important of our recommendations being that losses should be allowed to be set off against the profits of future years.

The Indian income-tax system reveals even more glaring defects when examined from the point of view of justice in taxation. There are certain personal elements in the concept of income which must be considered when taxing it. For example, apart from the amount of income, the way in which it is earned and the way in which it is spent effectively affect the individual's ability to pay, and the Indian income-tax seems to ignore the existence of this factor. We have therefore suggested the grant of an allowance of Rs. 250 per child to be deducted from the individual's assessable income, necessary safeguards against abuse being provided by limiting the allowance to a maximum of six children, and making it conditional upon proof of the child's regular attendance at a school. We have also recommended that unearned incomes should pay an amount of tax which should be 10 per cent. higher than that paid by earned incomes.

As regards graduation, we saw that the Indian system suffers from the fundamental defect of "jumps", the changes in the rate of the tax being disproportionate to changes in the amount of income. In addition to this fundamental defect in the very form of graduation, the Indian rates undoubtedly need a further steepening. To solve both these problems, we have recommended that graduation in the Indian system should now be based on British lines, and the scale of progression substantially raised. Thus, under our scheme, Rs. 2,000 will be allowed as a fixed abatement for all classes of tax-payers, and the first Rs. 15,000 will be taxed at one-half the standard rate, the standard rate being fixed at two annas in the rupee. The minimum income subjected to super-tax should be reduced from Rs. 50,000 to Rs. 30,000 and the rates

raised all throughout the schedule, reaching a maximum of as. 9 in the rupee as contrasted with the existing as. 6.

We then examined the incidence of the Indian tax on certain special classes of tax-payers, viz. companies, firms and Hindu Undivided Families. Companies and firms are a product of modern industrial conditions and are found everywhere, whereas the Hindu Joint Family is an institution peculiar to India. In examining the incidence, we have emphasised the principle that though special classes like these may be treated as taxable units for purposes of administrative convenience, they must be recognized as associations of individuals, and the incidence of the income-tax paid by them should be similar to that of the general income-tax on the individual's personal income. This principle, however, is not observed by the existing system. We have therefore suggested several changes the most important of which are the removal of the distinction between registered and unregistered firms, and the abolition of the super-tax levied on companies.

We have also recommended that statutory recognition should be given to the unique position of the Hindu Undivided Families. We have classified these families according as they live jointly or otherwise. We have suggested that the families joint in living should continue to be treated as individuals, but allowed to deduct from their assessable income the expenditure necessarily incurred in maintaining the coparceners of the joint property. In the case of families not living jointly, we have recommended that they should be taxed as ordinary associations so that they will be treated only as the means for taxing at source the Joint Family income of their members.

We have then considered the problem of double taxation. The existing system affords relief to income doubly taxed by Great Britain and India ; but as we have already pointed out, there are few Indians with 'British' incomes, while there are many Britishers with 'Indian' incomes.

The result is that the benefit of the existing relief accrues mainly to foreigners; whereas we have laid it down as a fundamental principle that every country should restrict relief only to its own nationals. We have therefore recommended the abolition of the existing provisions of relief from double income-tax, and its replacement by a new scheme of relief which will be restricted to the nationals of the country.

We have then considered certain important administrative problems and dealt with the vexed question of the association of non-officials with the administrative machinery. We have found ourselves unable to favour the association of non-officials in the work of assessment, but we have suggested the creation of administrative courts of justice to which an assessee may be entitled to appeal on questions of fact. We have recommended that the other things should be left as they are, and the High Courts should continue to decide questions of law.

If the suggestions we have made for the reform of the Indian income-tax system are carried out in practice, on the one hand it will be based on scientific principles of "ability" and justice; and on the other, it shall become a more powerful fiscal weapon than it is to-day.

We have also tried to analyse the economic conditions of the people as revealed by income-tax statistics. They abundantly prove that India is poor and that her economic progress has not been rapid. It is also found that considered historically, the richer and poorer assessees are being slowly overshadowed by those in the intermediate grades. We then attempted to arrange the provinces in order of economic prosperity, and arrived at certain interesting conclusions, such as that Bombay is the largest investing province, that Burma and Punjab come next to Bombay in the number of assessees per 1,00,000, and that though Bengal contributes the largest percentage of tax, she has only 90 assessees per 1,00,000 as contrasted with Bombay's 387.

APPENDIX I

RISE IN THE EXEMPTION LIMIT, 1903.

DEMAND FOR HIGHER EXEMPTION

The question was raised in the Imperial Legislative Council in the year 1889 and was followed by the definite suggestion that the minimum should be raised from Rs. 500 to Rs. 1000. The plea was revived, ten years later, by the Maharajah of Darbhanga. This demand was not merely confined to the Legislative Council but also extended beyond its confines. Ever since 1887 the Indian National Congress—the premier representative body of Indian public opinion—had been persistently passing resolutions in favour of raising the exemption limit. The agitation thus started in 1897 reached its culminating point in 1902. The Government had been receiving continuous surpluses and yet had made no provision for raising the taxable minimum. The Honourable Mr. Turner, a member of the Council, thereupon suggested that the exemption limit should forthwith be raised to Rs. 1200 per year. His proposal was greeted with a chorus of approval from the non-official members—both Indian and non-Indian.[1]

ANALYSIS OF THE DEMAND

Analysing the arguments of these members, there are revealed three distinct grounds on which the raising of the minimum was advocated.

(1) The assessees in the lower grades were mainly clerks and petty traders—middle class people, burdened with large families, and obliged to keep up appearances not a little inconsistent with their earnings. For them the pressure of the tax was very acute.

(2) The general price level had appreciably risen since the imposition of the tax and the cost of living had gone

[1] The Maharajah of Darbhanga, Messrs. Hardy, Charlu, Siri Ram, G. K. Gokhale, etc. were among those who enthusiastically supported the proposal.

up. So that the persons with a nominal income of Rs. 500 had their real income much below the statutory level.

(3) The assessees in the lower grades formed 60% of the total number, but paid even less than 20% of the total tax realised. At the same time, there was no satisfactory way by which the real income of persons of this class should be ascertained with accuracy. The petty traders and such others who came under these grades kept no accounts. And once they were reported as taxable persons they seldom escaped payment, for, in the absence of accounts, they could not successfully rebut the presumption raised against them. Thus, administrative difficulties were much more in evidence in connection with these assessees.

The popular case was undoubtedly strong, and Government promised to bear it in mind. Strangely enough, the promise was kept, the minimum being raised to Rs. 1000 by the Income-Tax Amendment Act of 1903. The long fight thus ended in success; and non-official opinion now received official consecration.[1]

THE NEW EXEMPTION IN PRACTICE

The class affected by the remission numbered 3,24,044 or nearly 61% of the total number of assessees; the tax paid by them amounted to Rs. 38 lakhs, or 19% of the total tax collected. In the natural course of events therefore the next year ought to have seen the tax reduced by 19%, the assessees by 61%. Actual results, however, proved otherwise, and the tax was reduced only by 14% and the assessees only by 57%.[2]

[1] It was admitted that under these grades, the tax fell largely on petty traders, clerks and widows in receipt of pensions. The Finance Member also alluded in euphemistic terms to his fear that "it is in the lower categories of incomes that hardship is perhaps felt in the matter of inquisitorial proceedings on the part of the assessors." F. S. 1903-04.

[2] In other words:—

Expected decrease in number of assessees......... 3,24,044.
Actual ,, ,, ,, ,, ,, ... 2,89,995.
Expected decrease in amount of Tax ....Rs. 37,86,997.
Actual ,, ,, ,, ,, ,, ...Rs. 30,04,538.
Statistics of British India, Part IV, Table 9 of Income-tax.

Two possible explanations were offered. One ascribed the unexpected increase in revenue in 1904 to a 'natural' increase in prosperity and an improvement in administrative machinery.[1] The other traced it to an unsatisfactory application of the new exemption, persons having been included, who ought not to have been in the lists.[2] It is the duty of the scientific historian of the Indian Income-Tax to examine these rival contentions and attempt an explanation that will be in accordance with facts.

Examining the figures of income-tax Collections from the various income grades for the years 1902 and 1903, we find that out of Rs. 7, 84, 164 that formed the total increase in 1903 (over the corresponding figure of 1902) Rs. 4, 17, 324 were furnished solely by the lowest grade—the one between Rs. 1000 and 1250. While thus the bulk of the increased revenue was contributed by the lowest income class, out of the 30,049 new assessees, a good majority, viz., 28,407, were again from that same grade. The only probable conclusion is that a number of persons, who in 1902 had been returned under Rs. 500-750 or Rs. 750-1000 and who ought to have been exempted under the new Act were now assessed as persons with incomes above Rs. 1000.

It was very easy for the Tashildar—in fact it was the line of least resistance—to thus nullify the effects of the Amendment to a certain extent, and include persons whose incomes were below the legal minimum. A historical examination of the figures of assessees[3] and the tax collected under the income grade 1000-1250 further strengthens our conclusion, for with the exception of the

[1] "The intended benefit was secured by all classes entitled to it and the difference between the estimated loss and that which has actually been incurred may be due to the increasing prosperity of the classes affected and also to improving administration" F. S. 1906—07.

[2] The Hon'ble Siri Ram Bhadur asserted that it "raises in one's mind a very strong suspicion that many persons who ought to have been exempted have either got no exemption at all or that they have been re-assessed. F. S. 1906—07.

[3] We have no All-India figures of appeal for these years; but even the right of appeal could avail the unfortunate assessees little, for they kept no accounts and in addition the appellate authority—the Collector—was the very person who assessed them to income-tax.

abnormal year 1903-04, they reveal (both before and after the Amendment) a normal increase of only 2000 in number of assessees and Rs. 20,000 in amount of tax.[1]

It can be confidently asserted therefore that the Hon'ble Mr. Siri Ram's suspicions were nearer the truth than the complacent optimism of the Financial statement of 1904.[2] The Government evidently recognized the truth of this charge for they issued executive instructions to the District Officers to see that any tendency to the undue assessment of persons below Rs. 1000 should be promptly checked. It is satisfactory to note that the order was not without effect.[3]

[1] The relevent figures are:—

Assesees.	Tax.	Assessees.	Tax.
1897-98—51,590	Rs. 10,79,840	1903-04—86,736	Rs. 16,46,126
1898-99—53,026	Rs. 11,03,505	1904-05—88,115	Rs. 17,09,339
1899-00—54,052	Rs. 11,13,533	1905-06—89,450	Rs. 17,17,266
1900-01—53,586	Rs. 11,22,783	1906-07—90,859	Rs. 17,32,001
1901-02—56,219	Rs. 11,85,152	1907-08—91,301	Rs. 17,68,333
1902-03—58,323	Rs. 12,20,802		

Statistics of British India. Part IV (b) 1913—P. 161.

[2] Official evidence can be produced in our support of our conclusion "There was undoubtedly a tendency on the part of Tashildars to include in the new lowest class as many assessees as possible who would otherwise have escaped taxation. It was inevitable that a certain portion of those formerly assessed at less than Rs. 1000 should not escape taxation entirely after the introduction of the Act." Punjab Triennial Report —1902-05. Also cf. the Bombay Triennial Report for the same period which asserted that from more than one district reports were received that, "The apprehension is expressed that there was at any rate in the case of the first assessments made according to the present taxable limits a tendency to include persons, whose incomes were formerly estimated to be less than Rs. 1000."

[3] cf. Madras Triennial Report— 1911-14.
Bihar and Orissa Triennial Report—1914-17.
Bombay ,, ,, 1905-08.

APPENDIX II

STATISTICS OF REVISION AND APPEAL, 1886-1919

The following are the only available figures relating to Revision and Appeal. They are obtained from the Annual Reports on the Moral and Material Progress of India for the earlier years when no triennial reports on income-tax were published, and from the available triennial provincial reports on the administration of the income-tax for the later years. It may be pointed out that Dr. Pagar's book contains figures only for a period of three years (1911-13) and that too only for the Province of Bombay.

Table 1. Original demand—number of assessees.
,, 2. Revision by Collector—No. of petitions or objections.
,, 3. Revision by Commissioner—No. of petitions or objections.
,, 4. Final demand—No. of Assessees.
,, 5. Original demand—Amount of tax.
,, 6. Revision by Collector—Demand after disposal.
,, 7. Revision by Commissioner—Demand after disposal.
,, 8. Final demand—Amount of tax.
,, 9. Consolidated statistics of Appeals.
,, 10. Statistics of Appeals—Revision by Collector.
,, 11. Statistics of Appeals—Revision by Commissioner.
,, 12. Percentage of successful appeals by provinces.

TABLE 1.

ORIGINAL DEMAND—NUMBER OF ASSESSEES

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma	TOTAL
1899-1900	88,719										
1900-1901	86,806										
1901-1902	90,929										
1902-1903	91,402	127,749	47,534								266685
1903-1904	47,114	52,864	20,771								120749
1904-1905	45,272	53,864	21,907								120733
1905-1906	44,377	53.554	21,584							16534	125143
1906-1907	45,878	42,648	22,709							16996	129634
1907-1908	46,705	44,051	23,190							17817	133812
1908-1909	47,587	46,100	25,254							18570	138385
1909-1910	48,493	46,974	25.576							19749	142221
1910-1911	51,220	48,404	25.792							20552	147142
1911-1912	53,972	49,578					49228			20893	172980
1912-1913	58,078	48,687					50962			22351	182609
1913-1914	62,548	51,218		5178	18430		54582	2251	34956	23950	255513
1914-1915	65,882	53.618	31,604	5513	18721	13414		2278	35757	24321	252468
1915-1916	68,056	54,878	32,480	5618	19092	13727			36187	23283	253937
1916-1917	73,296	55,494	36,074	6030	19629	15330			37943	24065	271603
1917-1918	83,378	59,236	32,432	6073		15883				25665	173431
1918-1919										25796	

TABLE 2.

REVISION BY COLLECTOR—NO. OF PETITIONS OR OBJECTIONS

	Bombay	Bengal	Punjab	As-sam	Bihar and Orissa	Nag-pur	Madras	N. W. Province	U. P.	Burma	TOTAL
1899-1900	18,819										18819
1900-1901	19,018										19918
1901-1902	25,367										25367
1902-1903	25,809	11,656	14,846								52307
1903-1904	15,065	8,499	8,293								31857
1904-1905	12,563	6,614	7,598								26775
1905-1906	9,825	4,809	6,860							3868	25362
1906-1907	10,580	4,992	7,809							3486	26867
1907-1908	11,110	5,387	7,274							3271	27042
1908-1909	11,303	5,531	9,650							3935	30419
1909-1910	11,952	5,371	8,991							4100	30414
1910-1911	13,143	5,815	8,388				11,535			4037	31383
1911-1912	12,987	3,895					12,101			3868	32285
1912-1913	14,547	4,439					14,039			4144	35231
1913-1914	15,294	4,218	10,697	773	3400			961	3108	4551	46344
1914-1915	16,740	3,937	10,569	759	3155	1632		864	3000	4410	45204
1915-1916	17,126	4,022	11,640	593	3038	1560			2620	4385	43911
1916-1917	18,112	5,364	14,063	742	3151	1776			2790	3962	47537
1917-1918	20,422			674		1462				4148	40769
1918-1919										2344	

TABLE 3.

REVISION BY COMMISSIONER—NO. OF PETITIONS OR OBJECTIONS

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. P.	U. P.	Burma	TOTAL
1899-1900	577										577
1900-1901	1083										1083
1901-1902	661										661
1902-1903	581	456	1573								2550
1903-1904	378	488	1225								2091
1904-1905	396	467	1085								1948
1905-1906	338	325	846							185	1694
1906-1907	296	280	942							176	1694
1907-1908	395	326	892							211	1824
1908-1909	335	289	1064							204	1892
1909-1910	316	305	1060							158	1839
1910-1911	409	216	1055							143	1823
1911-1912	436	101					1537			176	2250
1912-1913	456	96					1463			186	2201
1913-1914	429	107		68	91		1742	139	136	242	2954
1914-1915	410	119	901	38	61	23		159	137	177	2025
1915-1916	542	137	825	42	53	29			119	239	1986
1916-1917	635	218	786	30	103	33			97	160	2065
1917-1918	593		883	7		36				97	1639
1918-1919										140	

TABLE 4.

FINAL DEMAND—NUMBER OF ASSESSEES

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma	TOTAL
1899-1900	82,961										
1900-1901	82,312										
1901-1902	83,579										
1902-1903	84,197	1,26,109	45,265								255571
1903-1904	41,484	51,478	19,114								112076
1904-1905	42,394	52,493	20,300								115187
1905-1906	42,632	41,955	20,004							14503	119094
1906-1907	44,273	43,455	21,014							15667	124399
1907-1908	44,723	45,472	21,723							16653	128571
1908-1909	45,495	16,317	23,115							17399	132326
1909-1910	46,239	47,715	23,572							18182	135708
1910-1911	48,997	48,837	24.039							18864	140737
1911-1912	51,579	48,312					47,865			19390	167146
1912-1913	55,580	50,600					49,768			20675	176623
1913-1914	59,805	52,878		4,949	18,141		53,234	2,023	33839	22355	247224
1914-1915	62,735	54,176	29,509	5,352	18,445	12,894		2,076	34630	22434	212251
1915-1916	65,082	54,736	30,406	5,509	18,768	13,334			35286	21506	244627
1916-1917	70,678	58,338	34,578	5,857	19,385	14,975			36985	22224	263020
1917-1918	80,081		40,690	5,954	15,514					23923	166162
1918-1919										24309	24309

TABLE 5.

ORIGINAL DEMAND—AMOUNT OF TAX (In thousands of Rupees)

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma	TOTAL
1899-1900	46,47										46,47
1900-1901	42,65										42,65
1901-1902	39,61										39,61
1902-1903	40,09	53,99	12,95								107,93
1903-1904	34,73	45,77	10,51								91,01
1904-1905	35,48	45,84	10,93								92,26
1905-1906	34,66	42,75	11,04							14,32	102,78
1906-1907	45,26	44,71	12,00							13,94	115,91
1907-1908	47,12	48,10	12,22							15,72	123,16
1908-1909	45,20	53,17	13,61							16,63	128,61
1909-1910	45,87	52,24	13,19							17,11	127,42
1910-1911	49,39	50,41	13,68							17,35	130,83
1911-1912	52,05	48,46					29.49			17,50	147,50
1912-1913	57,55	51,32					30,75			17,50	157,12
1913-1914	66,57	61,42		3.60	11,88		24.32	1,13	23,19	21,12	223,54
1914-1915	69,68	65,62	15.66	3,83	12,34	7,57		1,14	23,53	24,05	222,32
1915-1916	77,89	66.55	16,48	3,94	12.36	7,92			23,92	22,97	232,04
1916-1917	158,43	171.37	24,45	6,00	17.74	11,05			37,21	39,94	466,19
1917-1918	223,51		32.61	7.34		12,99				48,59	324,84
1918-1919										64,08	64,08

TABLE 6.

REVISION BY COLLECTOR—DEMAND AFTER DISPOSAL (In thousands of Rupees)

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma	TOTAL
1899-1900	33,06										33,07
1900-1901	33,35										33,35
1901-1902	33,17										33,17
1902-1903	34,11	52,76	12,23								99,10
1903-1904	29,86	44,28	9,67								83,81
1904-1905	32,75	44,70	10,18								87,63
1905-1906	33,14	42,07	10,21							12,87	98,29
1906-1907	43,25	43,96	11,04							12,84	111,10
1907-1908	44,08	47,46	11,32							14,46	117,32
1908-1909	42,63	52,31	12,24							14,93	122,11
1909-1910	41,47	51,40	12,09							15,39	120,35
1910-1911	45,59	49,67	12,64							15,81	123,71
1911-1912	48,30	47,77					28,55			15,94	140,56
1912-1913	52,64	50,63					29,77			16,06	149,10
1913-1914	61,02	60,53		3,49	11,59		33,21	1,05	22,35	19,45	212,69
1914-1915	63,19	64,82	14,65	3,73	12,00	7,18		1,07	22,75	21,86	210,25
1915-1916	67,54	65,74	15,28	3,84	12,12	6,82			23,26	20,54	215,14
1916-1917	140,57	167,92	23,08	5,88	17,23	10,44			35,47	38,79	439,38
1917-1918	202,10		30,74	7,19		12,46				46,10	298,59
1918-1919										63,11	63,11

TABLE 7.

REVISION BY COMMISSIONER—DEMAND AFTER DISPOSAL (In thousands of Ru

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma
1899-1900	14,73									
1900-1901	33,35									
1901-1902	33,13									
1902-1903	33,51	52,74	12,20							
1903-1904	29,26	44,92	9,63							
1904-1905	32,50	44,63	10,14							
1905-1906	32,76	42,05	10,19							12,82
1906-1907	42,86	43,96	10,98							12,81
1907-1908	43,54	47,46	11,29							14,43
1908-1909	42,32	52,29	12,19							14,90
1909-1910	41,02	51,35	12,04							15,33
1910-1911	45,68	49,66	12,59							15.79
1911-1912	48,13	47,77					28,44			15.82
1912-1913	52,18	50,62					29.63			15,96
1913-1914	60,09	60,53		3,48	11,59		33,10	1.02	22.29	19.36
1914-1915	62,51	64,82	14,54	3,73	12,00	7.18		1,05	21,79	21,82
1915-1916	67,15	65,70	15,24	3,81	12,11	6,06			23.19	20,36
1916-1917	140.02	167,87	23.03	5,88	17,15	10,41			35.39	36,02
1917-1918	200,42		30,68	7,13		12,44				43,56
1918-1919										62,99

TABLE 8.

FINAL DEMAND—AMOUNT OF TAX (In thousands of Rupees)

	Bombay	Bengal	Punjab	Assam	Bihar and Orissa	Nag-pur	Madras	N. W. F. Province	U. P.	Burma
1899-1900	33,06									
1900-1901	33,36									
1901-1902	33,14									
1902-1903	34,06	52,74	12,20							
1903-1904	29,85	44,92	9,63							
1904-1905	32,83	44,63	10,14							
1905-1906	33,12	42,05	10,19							12,81
1906-1907	43,26	43,96	10,98							12,81
1907-1908	44,26	47,46	11,29							14,43
1908-1909	42,62	52,29	12,10							14,19
1909-1910	41,63	51,35	12,04							15,33
1910-1911	45,68	49,66	12,59							15,79
1911-1912	48,46	47,77					28,42			15,88
1912-1913	52,78	50,63					29,60			15,96
1913-1914	61,21	60,53		3,48	11,59		33,08	1,02	22,29	19,36
1914-1915	63,38	64,82	14,54	3,73	12,09	7,18		1,06	21,71	21,83
1915-1916	67,70	65,70	15,24	3,84	12,11	7,53			23,19	20,47
1916-1917	140,52	167,87	23,04	5,88	17,24	10,42			35,39	36,02
1917-1918	201,96		30,68	7,20		12,44				43,48
1918-1919										63,05

TABLE 9.

CONSOLIDATED STATISTICS OF APPEALS

	Percentage of Objections to original Demand.	Percentage of successful Objections to total objections.
1899-1900	21	29
1900-1901	22	23
1901-1902	28	27
1902-1903	20	45
1903-1904	26	27
1904-1905	22	23
1905-1906	20	25
1906-1907	21	19
1907-1908	22	18
1908-1909	21	24
1909-1910	21	24
1910-1911	19	21
1911-1912	19	21
1912-1913	18	17
1913-1914	18	17
1914-1915	17	24
1915-1916	17	24
1916-1917	17	18
1917-1918	23	17

TABLE 10.

STATISTICS OF APPEALS—REVISION BY COLLECTOR

	Percentage of objections before Collector to Total number of assessees.	Percentage of deduction of Original Assessment by Collector's Revision.
1899-1900	21	
1900-1901	22	22·0
1901-1902	28	16·0
1902-1903	20	8·1
1903-1904	26	8·0
1904-1905	22	5·0
1905-1906	20	5·0
1906-1907	21	4·0
1907-1908	22	5·0
1909-1910	21	6·0
1910-1911	19	5·0
1911-1912	19	5·0
1912-1913	18	5·1
1913-1914	18	5·0
1914-1915	17	5·0
1915-1916	17	7·1
1916-1917	17	6·1
1917-1918	23	9·2

TABLE 11.

STATISTICS OF APPEALS—REVISION BY COMMISSIONER

	Percentage of objections before Commissioner to objections before Collector	Percentage of reduction of assessment by Commissioner's Revision
1900-1901	5·7	·0
1901-1902	2·6	·1
1902-1903	4·9	·7
1903-1904	6·2	·8
1904-1905	7·3	·4
1905-1906	6·7	·5
1906-1907	6·3	·5
1907-1908	6·7	·5
1908-1909	6·2	·3
1909-1910	6·0	·5
1910-1911	7·0	·3
1911-1912	7·0	·3
1912-1913	6·2	1·0
1913-1914	6·3	·6
1914-1915	4·2	·5
1915-1916	4·5	·7
1916-1917	4·3	·8
1917-1918	4·0	1·5

TABLE 12.

PERCENTAGES OF SUCCESSFUL APPEALS BY PROVINCES

	Bengal	Bombay	N. W. Provinces	Madras	Punjab	Lower Burma	Assam
1888— 89	41.0	nil	30.0	43.0	31.0	40.0	
1889— 90	42.0		29.0	38.0	29.0		46.0
1890— 91	38.0		30.0	35.0	33.0	63.0	51.0
1891— 92	36.0		31.0				
1892— 93	36.0	3.5 to 5.0	31.0	32.0	37.0	62.0	42.0
1893— 94	37.0	5.0	29.0		32.0	42.0	45.0
1894— 95	33.0	4.0	31.0	29.0	30.0	42.0	39.0
1895— 96	31.0		27.0	30.0	35.0	32.0	48.0
1896— 97	32.0		28.0	26.0	34.0	60.0	38.0
1897— 98	33.3		27.5	24.0	34.0	52.0	44.0
1898— 99	33.8				36.0		
1899—1900	33.0			21.0	34.0	42.0	

APPENDIX III

FIGURES OF ASSESSEES, TAX COLLECTED, COST OF COLLECTION AND NET YIELD FOR THE PERIOD, 1886—1916

Period	No. of Assessees (in thousands).	Amount of Tax collected (in lakhs).	Cost of Collection (in lakhs).	Net yield (in lakhs).
1886-87	351	137	5.3	134
1887-88	394	140	2.8	137
1888-89	410	149	2.7	146
1889-90	417	155	2.8	152
1890-91	426	158	2.9	155
1891-92	436	161	3.0	158
1892-93	445	166	3.0	163
1893-94	456	171	3.1	168
1894-95	466	179	3.0	176
1895-96	477	182	3.0	179
1896-97	477	186	3.0	183
1897-98	481	188	3.2	185
1898-99	491	190	3.2	187
1899-00	502	193	3.3	190
1900-01	499	197	3.3	194
1901-02	514	204	3.5	200
1902-03	531	210	3.6	206
1903-04*	246	180	3.4	177
1904-05	243	189	3.1	186
1905-06	249	197	3.4	194
1906-07	256	212	3.6	208
1907-08	262	224	3.9	220
1908-09	268	230	4.0	226
1909-10	276	232	4.1	228
1910-11	278	230	4.2	226
1911-12	289	240	4.4	236
1912-13	304	253	4.6	248
1913-14	322	284	4.8	279
1914-15	339	298	5.0	293
1915-16	343	305	5.3	300

* The minimum exempted was raised from Rs. 500 to Rs. 1000 per annum.

SOURCE: This Table is compiled from figures given in Return 1 and 2 relating to Income-Tax Statistics of British India, Part iv (a) for 1910-11 and preceding years; the figures for 1911-12 to 1915-16 are gathered from Tables 117 and 118 of the Statistical Abstract of British India Vol. ii . . . 1917.

APPENDIX IV

DETAILS OF DEPRECIATION ALLOWANCE UNDER THE INDIAN INCOME-TAX ACT.

The percentages of the original cost allowed as depreciation allowance on various buildings, machinery, plant and furniture are given below. They are taken from Rule 8, Part II. of the Indian Income-Tax Manual.

Class of buildings, machinery, plant or furniture	Rate percentage on prime cost
1. Buildings[1]	
(1) First class substantial buildings of selected materials	$2\frac{1}{2}$
(2) Buildings of less substantial construction ...	5
(3) Purely temporary erections such as wooden structures...	10
2. Machinery, plant or Furniture[2]	
General rate	5
Rates sanctioned for special industries	
Flour Mills, Rice Mills, Bone Mills, Sugar Works, Distilleries, Ice Factories, Aerating Gas Factories, Match Factories	$6\frac{1}{2}$
Paper Mills, Ship Building and Engineering Works, Iron and Brass Foundries, Aluminium Factories, Electrical Engineering Works, Motor Car Repairing Works, Galvanizing Works, Lime Works, Patent Stone Works, Oil Extraction Factories, Chemical	

[1] Double these rates may be allowed for buildings used in industries which cause special deterioration, such as chemical works, soap and candle works, paper mills, and tanneries.

[2] The special rates for electrical machinery given below may be adopted, at firm's (assessee's) option, for that portion of their machinery.

Class of buildings, machinery, plant or furniture	Rate Percentage on prime cost
Works, Soap and Candle Works, Lime Works, Saw Mills, Dyeing and Bleaching Works, Furniture and Plant in hotels and boarding houses, Cement Works using rotary kilns...	7½
Plant used in connection with Brick Manufacture Tilemaking Machinery, Optical Machinery, Glass Factories, Telephone Companies, Mines and Quarries.	10
Sewing Machines for canvas or leather	12½
Motor Cars used solely for the purpose of business, Indigenous sugarcane crushers (Kohlus or Belnas)	15
Motor taxis, motor lorries and motor buses ...	20
3. Electrical Machinery	
(*a*) Batteries	15
(*b*) Other electrical machinery including electrical generators, motors (other than tramway motors), switchgear and instruments, transformers and other stationary plant and wiring and fittings of electric light and fan installations	7½
(*c*) Underground cables and wire	6
(*d*) Overhead cables and wires	2½
4. Hydro-Electric concerns	
Hydraulic Works, pipe lines, sluices and all other items not otherwise provided for in this statement	2½
5. Electric tramways	
Permanent way	
(*a*) Not exceeding 50,000 car miles per mile of track per annum	6¼
(*b*) Exceeding 50,000 and not exceeding 75,000 car miles per mile of track per annum ...	7 1/7
(*c*) Exceeding 75,000 and not exceeding 125,000 car miles per mile of track per annum ...	8 1/3

Class of buildings, machinery, plant or furniture	Rate Percentage on prime cost
Cars, car trucks, car bodies, electrical equipment and motors	7
General plant, machinery and tools	5
6. Mineral Oil Companies...	
A. Refineries	
(1) Boilers	10
(2) Prime movers	5
(3) Process Plant	10
B. Field operations	
(1) Boilers	10
(2) Prime movers	5
(3) Process plant	7½
Except for the following items	
(1) Below ground—All to be charged to revenue	...
(2) Above ground	
(*a*) Portable boilers, drilling tools, well-head tank, rigs, etc.	25
(*b*) Storage tanks	10
(*c*) Pipe-lines...	
(i) Fixed boilers	10
(ii) Prime movers	7½
(iii) Pipe line	10
7. Ships	
(1) Ocean	
(*a*) Steam	5
(*b*) Sail or tug	4
(2) Inland	
(*a*) Steamers (over 120 ft., in length)	5
(*b*) Steamers including cargo launches (120 ft. in length and under)...	6
(*c*) Tug Boats	7½
(*d*) Iron or Steel flats for cargo, etc.	5

Class of buildings, machinery, plant or furniture.	Rate Percentage on prime cost.
(*e*) Wooden cargo boats up to 50 tons capacity	10
(*f*) Wooden cargo boats over 50 tons capacity	$7\frac{1}{2}$
8. Mines and Quarries	
(1) Railway siding[1] (excluding rails)...	5
(2) Shafts	5
(3) Inclines	5
(4) Tramways on the surface (excluding rails)	10

[1] Depreciation on rails, used for tramways and sidings, and inclines where the rails are the property of the assessee, is allowed at 10 per cent. under item 2 above (plant used in connection with Mines and Quarries) in addition to any depreciation allowance on the cost of constructing the tramways sidings or inclines.

APPENDIX V

BASIS FOR ESTIMATING THE AMOUNT OF INCOME-TAX REALIZABLE FROM TEMPORARILY SETTLED ESTATES

The number of persons holding more than 500 acres per head amount in the Bombay Presidency to 3169, out of which 2251, are residents of Sind. The incidence of Land Revenue per acre calculated from figures compiled from the Bombay Land Revenue administration Report 1926-27, amounts to Rs. 1-8-9. Reference to appendix S. of the Bombay Land Revenue Assessment Committee Report, shows that the maximum percentage of rent taken by land revenue did not exceed on an average 29%. If we take the normal rate to be 20% then, the rent realised per acre would amount to Rs. 7-11-9, or approximately eight rupees. Rent however is only a part of the cultivator's profits; we should make an allowance for his own cost of subsistence and interest on his capital. If we assume these to be as much as the rent, then the real income from an acre will be Rs. 16. On this basis, there are 3169 persons in this Presidency getting more than Rs. 8000/- per year. If we assume that 500 of these persons to have more than Rs. 30,000/- we can easily realise from them a tax of about thirty lakhs of rupees. Making allowances for the land Revenue payable, the net benefit to the state will hardly be more than Rupees ten lakhs. Mr. Mackay, Settlement Commissioner and Director of Land Records, Bombay, estimated the revenue at Rs. 20 lakhs. Mr. Montford, Commissioner of Central Division, estimated it at 25 lakhs. Their figures however do not falsify our estimate, their methods being just as crude, pages 398 and 437 Vol. VI. T. E.

In the Madras Presidency there are 3635 Pattas (certified ownership of the land) paying Land Revenue of Rupees over 500 per head:—from them 926 pay more than Rs. 1000/- each. (vide Madras Land Revenue Report 1913-14.) The Taxation Enquiry Committee has pointed out (page 77 Vol. 1) that the average percentage of assessment to rental is somewhere about 17. Adopting this percentage, and making an allowance for labour

charges and agricultural profits, we may say that the net income per every rupee of land revenue paid will probably be Rupees twelve. On this basis, there are about 926 persons with income exceeding Rs. 12,000/-. When we further remember that more than one Patta is held by the same person, it will not be rash to assume that there are about 600 persons with incomes exceeding Rs. 30,000/-. Probably Rs. 40 lakhs, can be realised from them by way of income and super-taxes. Making an allowance for land revenue, we can estimate a net addition of Rs. 20 lakhs.

The tea estates of Assam can safely be estimated to yield Rupees twenty-five lakhs. (Page 383-4. Vol. V. T. E. Ibid. evidence of Mr. Grimson, Commissioner of Income-tax Assam.)

From the Central Provinces, it is expected that Rupees 40 lakhs will be realised. (Vide evidence of commissioner of income-tax; page 234 Vol. IV. T. E.); but as our scheme contemplates the taxation of only persons with incomes above Rs. 30,000, and as land revenue will also be deductible from the income-tax, we can only hope for about Rupees ten lakhs.

In Burma the total land revenue collected is Rs. 392 lakhs. (Vide Land Revenue Administration Report for 1926-27.) According to Mr. Smith, Commissioner, North-Western Border division, Burma, cultivators with more than Rs. 2000/- a year are hardly more than 1% of the total number. Similar percentage in Bombay is somewhere above the same level. Persons holding more than 100 acres getting more than a thousand Rupees each formed about 3% of the total number. We can therefore, assume that the yield in Burma will also be about five lakhs.

The yield from Punjab will not be very appreciable.

For the United Provinces there are no figures available and we can roughly take the yield at Rupees five lakhs.

Bombay...	10,00,000
Madras ...	20,00,000
Assam ...	25,00,000
Central Provinces ...	10,00,000
Burma ...	5,00,000
United Provinces ...	5,00,000
Total from all the temporarily settled provinces Rs.	75,00,000

APPENDIX VI

STATEMENT SHOWING DIFFERENT SCHEMES OF PROGRESSION ADVANCED BEFORE THE TAXATION ENQUIRY COMMITTEE

The following statement sets forth the various schemes of progression proposed by several witnesses before the Taxation Enquiry Committee. They all suffer from the defect of not providing a remedy for jumps; and with the exception of Mr. Mountford's scheme, the others do not contemplate any changes in the super-tax rates.

GRADUATION

Khan Wali Muhammad (Commissioner of Income-Tax of C. P.) proposed the following schedule of rates in place of the existing one.

Income Grade	Present Rate	Proposed Rate.
1000- 1,999	Nil ...	4 pies.
2000- 3,499	5 pies	5 ,,
3500- 7,499	5 and 6 pies	6 ,,
7500-12,499	6 and 9 ,,	9 ,,
12,500-14,999	9 ,,	12 ,,
15,000-19,999	9 ,,	15 ,,
20,000-29,999	12 ,,	18 ,,
30,000-39,999	13 ,,	21 ,,
40,000 and over	18 and 24 ,,	

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Mr. L. J. Mountford, Commissioner, Central Division suggested the following scheme, with the first £100 being free from:—

£	Present	Proposed	England
300	2·6	4	0-68
500	3·12	6	3·3-12·5
1000	4·7	7	10·8-18·8
2000	7·8	10	17 -22·7
5000	11·5	15	28 -30·8
10000	14·6	20	38 -39
50000 and upwards	32·9	40	50 -50

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Mr. H. G. Cocke, M. L. A. suggested the following scale of Graduation in place of the existing one.

When income is	less than Rupees 1500 ...	...	... Nil		
,, ,,	between 1500 and 5000 ...	6	pies	in the	Rupee
,, ,,	5000 ... 10,000 ...	7	,,	,,	,,
,, ,,	10,000 ... 15,000 ...	9	,,	,,	,,
,, ,,	15,000 ... 20,000 ...	10	,,	,,	,,
,, ,,	20,000 ... 30,000 ...	13	,,	,,	,,
,, ,,	30,000 ... 40,000 ...	16	,,	,,	,,
Over	40,000	20	,,	,,	,,

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Mr. Middleton (Commissioner of Income-Tax, Bihar and Orissa)

Rs.	1500- 2499-	3	pies	in the	Rupee
,,	2500- 4999-	5	,,	,,	,,
,,	5000- 9999-	6	,,	,,	,,
,,	10,000-14,999-	9	,,	,,	,,
,,	15,000-19,999-	12	,,	,,	,,
,,	20,000-29,999-	15	,,	,,	,,
,,	30,000-39,999-	18	,,	,,	,,

Rupees 40,000 and upwards 24 pies in the Rupee

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Professor Solomon of the Aligarh University suggested the following scheme of graduation in place of the existing one:—

1.	Income below	Rs.	1200	per annum ...	Nil		
2.	.. between	...	1200- 2430	,, ,,	3	pies	in Re.
3.	.. ,,	...	2400- 3600	,, ,,	4	,,	,,
4.	.. ,,	...	3600- 6000	,, ,,	5	,,	,,
5.	.. ,,	...	6000-10,800	,, ,,	6	,,	,,
6.	.. ,,	...	10,800-18,000	,, ,,	9	,,	,,
7.	.. ,,	...	18,000-24,000	,, ,,	12	,,	,,
8.	.. ,,	...	24,000-36,000	,, ,,	18	,,	,,
9.	.. ,,	...	36,000-60,000	,, ,,	24	,,	,,

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APPENDIX VII

PERCENTAGE OF INCOME TAKEN BY WAY OF INCOME AND SUPER-TAXES IN DIFFERENT COUNTRIES

Grades of Income	India	United Kingdom	Canada Dominion	South Africa Union	Japan	United States
2052	2·58				3	
4999	2·58	4·00			5	
5026	3·12	4·03			5	
9999	3·12	11·00	10·71	5·01	8	·06
10163	4·68	11·15	0·71	5·01	8	0·08
19999	4.68	15·50	3·34	5·23	9·5	0·78
20332	6·25	15·57	3·42	5·23	9·5	0·80
20999	6·25	17·42	5·43	5·38	13	1·58
30507	7·81	17·83	5.53	5·39	13	1·62
39999	7·81	19·20	7·40	6·73	13	2·65
40686	9·37	19·33	7·53	6·95	13	2·69
50000	9.37	20·85	9·30	9·81	15	3·65
100000	12·50	27·68	15·62	17·39	17	7·89
150000	14·58	31·96	18·94	21·38	21	10·90
200000	16·41	33·93	21·56	25·33	21	13·53
250000	18·13	36·62	23·81	29·26	21	15·51
300000	19·79	38·34	25·89	33·18	23	17·02
350000	21·13	39·73	27·68	34·84	23	18·16
400000	23·05	40·63	29·30	34·87	23	19·01
450000	24·65	41·67	30·64	34·88	23	19·68
500000	26.25	42·51	31·82	34·89	23	20·21
550000	27·84	43·19	32·84	34·90	23	20·71
600000	29·43	43·75	33·77	34·91		21·01

This table of rates is prepared from a calculation of the rates of the tax as given in the British Finance Act 1926, the 26th Japanese Financial and Economic Annual, the United States Revenues Act (1926) and Income Taxes in British Dominions. The Japanese rates rise to 36% on Incomes exceeding Rs. 55 lacs and the Canadian rates rise to 41.83% on incomes exceeding 15 lacs. The rates of Exchange are taken from page 162. Spaulding Dictionary of the World's Currencies.

The amounts of income given in column 1 (on which the rates for the different countries are calculated) are chosen because they coincide with the amounts on which the Indian rates of Tax are charged.

APPENDIX VIII

EFFECTIVE RATE OF INCOME-TAX AND SUPER-TAX (COMBINED) UNDER THE PRESENT SYSTEM AND THE PROPOSED SCHEME

Incomes (Rs.)	Present Rate	Proposed Rate
2052	2.58	Nil.
4000	2.58	1.56
6000	3.12	3.13
8000	3.12	3.91
10000	4.68	4.38
12000	4.68	5.20
14000	4.68	5.36
15000	4.68	5.42
17000	4.68	6.25
19000	4.68	6.91
21000	6.25	7.44
23000	6.25	7.75
25000	6.25	8.23
27000	6.25	8.56
29000	6.25	8.84
30,000	6.30	8.96
40,000	9.37	10.23
50,000	9.37	11.31
100,000	12.50	14.91
150,000	14.58	17.23
200,000	16.41	19.17
250,000	18.13	21.27
300,000	19.79	23.46
350,000	21.43	25.91
400,000	23.05	26.14
450,000	24.65	30.39
500,000	26.25	32.67
550,000	27.84	33.68
600,000	29.43	35.82
650,000	30.77	37.88
700,000	31.92	40.08

APPENDIX IX

SUPER-TAX ON THE UNDISTRIBUTED INCOME OF COMPANIES IN GREAT BRITAIN

The first attempt of such a character was made in 1922 by Section 21 of the Finance Act of that year, which authorized the Special Commissioners to treat as distributed any undistributed income of companies when in their opinion, the companies have not distributed a reasonable portion of their income, having regard not only to the current requirements of the companies' business, but also to such other requirements as may be necessary or advisable for the maintenance and development of that business. The Section was to apply to companies whose shareholders do not number more than 50, whose shares have not been open to public subscription, and who are under the control of not more than 5 persons. This was replaced in 1927 by subsection 3 of Section 31 of the Finance Act of that year which reads as under:—

"This section shall not apply to any Company which is under the control of not more than five persons and which is not a subsidiary company or a company in which the public are substantially interested."

The evidence of substantial public interest was to be found in not less than 25 per cent. of the shares of such a company being held by the public, and in such shares being quoted in the official list of a recognised stock exchange.

We have already pointed out the defect of these qualifications. Though a share may be quoted on the stock exchange, in practice it may not be available for purchase; and though 25 per cent. of the shares may be nominally held by the public, in reality the whole company might be a one-man concern. Under the circumstances, we feel that the section if embodied in the Indian Law, should embrace all companies, discretion being given to the Income-Tax Officer to decide which companies, by an unreasonable

building up of reserves, are evading the personal super-tax due from their shareholders. The Indian Law should contain the same provisions for appeal which are contained in the British Law. Similar provision must also be made to tax such companies when they go into voluntary liquidation. With the modification suggested above, it is worth while embodying the British portion of the Law relating to the taxation of the undistributed income of companies into the Indian Statute.

APPENDIX X

BASIS FOR ARRIVING AT THE NUMBER OF HINDU JOINT FAMILIES ASSESSED TO INCOME-TAX

The following method has been adopted in arriving at the number of Hindu Undivided Families paying tax.

Return No. IV.-A. of the All India Income Tax Report and Return gives figures of tax realized from these Families per each income grade. Thus, in 1926-27, Hindu Undivided Families with incomes between Rs. 2,500 and 3,000 paid a tax of Rs. 3,52,149.[1] The tax payable by a Hindu Undivided Family with an Income of Rs. 2,500 is, at the rate of 5 pies, Rs. 64-9-4; similarly the tax payable by a Hindu Undivided Family with an income of Rs. 3,000 is, at the rate of 5 pies, Rs. 78-0-9. The mean of these two amounts is Rs. 71-5-0 which is the average tax paid by these families with incomes between Rs. 2,500 and Rs. 3,000. Dividing the total tax realized from this grade viz. Rs. 3,52,149 by the average tax payable, we get the number of Hindu Undivided Families paying income-tax with their incomes between Rs. 2,500 and 3,000, which is 4,938. The figure of assessees is of course not completely correct, as some families might have their income just above Rs. 2,500 and some others just below Rs. 3,000. All the same, it can be asserted that the figure is fairly accurate.

In a similar way, we have found the number of Hindu Undivided Families paying tax under each grade, and then added them up to get the total number of tax-paying Hindu Undivided Families. The results of our calculations for the four years between 1923 and 1927 are reproduced in the accompanying table.

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1 Return IV. A. All India Income Tax Report and Returns 1926-27.

HINDU UNDIVIDED FAMILIES

(Assessees in Income Grades)

Income Grade	1923-24	1924-25	1925-26	1926-27
2000- 2500	5,075	5091	6,305	7,995
2500- 3000	2,980	3,043	3,675	4,938
3000- 3500	2,303	2,366	3,081	4,366
3500- 5000	3,712	3,944	5,209	7,341
5000- 7500	2,815	3,150	4,018	5,744
7500-10000	1,033	1,355	1,825	2,599
10,000-12,500	751	760	1,021	1,543
12,500-15,000	339	360	469	683
15,000-20,000	441	484	592	837
20,000-25,000	380	255	343	476
25,000-30,000	162	141	195	268
30,000-40,000	182	153	226	302
40,000-50,000	80	100	97	133
50,000 & upwards *	264	277	278	251
Total	10,766	21,479	27,014	37,476

Note:—This table is prepared from figures given in Return IV-A, Reports of the Central Board of Revenue for the years 1923-24 to 1926-27. The method employed has already been described.

* The figures given for Rs. 50,000 and upwards are taken from table V-A. which relate to super-tax; and are therefore, strictly speaking figures of income of Rs. 75,000 and upwards.

APPENDIX XI

GOVERNMENT NOTIFICATION ON DOUBLE TAXATION BETWEEN BRITISH INDIA AND INDIAN STATES

This notification issued by the Government of India deals with the problem of double taxation between British India and the Indian States.

FINANCE DEPARTMENT (CENTRAL REVENUES)

NOTIFICATION

Income-tax

Simla, the 1st July, 1926

No. 25. In exercise of the powers conferred by section 60 of the Indian Income-tax Act, 1922 (XI of 1922) the Governor-General-in-Council is pleased to make the following modifications in respect of Income-tax, in favour of income on which Income-tax has been charged both in British India and in one of the Indian States referred to in the schedule to this notification (hereinafter called the said schedule) namely:—

1. In this notification

   (a) the expression "State Income-tax" means Income-tax and Super-tax charged in accordance with the provisions of the Law relating to Income-tax for the time being in force in the State concerned;

   (b) the expression "State rate of tax" means the amount of State Income-tax divided by the amount of the larger of the two incomes on which Income-tax and Super-tax respectively have been charged by the State; and

   (c) the expressions "Indian Income-tax" and Indian rate of tax have the same meanings as in clauses (a) and (b), respectively, of section 49 (2) of the Act.

2. (1) If any person who has paid Indian Income-tax for any year on any part of his income, proves to the satisfaction of the

Income-tax Officer that he has paid State Income-tax for the corresponding year in any of the States mentioned in the said Schedule, he shall be entitled to the refund of a sum calculated on that part of his income at a rate equal to half the State rate of tax.

Provided that the rate at which the refund shall be given shall not exceed one-half of the Indian rate of tax.

(2) For the purpose of sub-paragraph (1) the Central Board of Revenue may from time to time determine the year of assessment in any State which shall be deemed to correspond with any British Indian year of assessment.

3. Every application for refund of income-tax under this notification shall be made to the Income-tax Officer of the district in which the applicant is chargeable directly to income-tax or if he is not chargeable directly to income-tax, to the Income-tax Officer for the district in which the applicant ordinarily resides, or if he is not resident in British India.

(i) to the Income-tax Officer of the district or area in which he was last charged directly to income-tax when so resident, or

(ii) if he has never been so resident, to the Income-Tax Officer of the district or area where the income-tax for the refund of which application is made was deducted.

Such application may be presented by the applicant in person or by a duly authorised agent or may be sent by post.[1]

SCHEDULE

1. Baroda.

Madras States Agency.

2. Travancore.

Central India Agency.

3. Dhar.

Punjab States Agency.

4. Patiala.

5. Bahawalpur.

6. Jind.

7. Kapurthala.

8. Laharu.

8A. Maler Kotla.

Bombay.

9. Sachin.

[1] The form of the application for relief is omitted from this Appendix.

10. Akalkot.
11. Phaltan.

United Provinces.

12. Benares.

Central Provinces.

13. Bastar.
14. Kanker.
15. Raigarh.
16. Jashpur.
17. Sarangarh.
18. Makrai.
19. Kawardhs.
20. Khairagarh.
21. Korea.
22. Nandgaon.
23. Chhuikhadan.

Bihar and Orissa.

24. Mayurbhanj.

Punjab.

25. Baghat.

The following Indian States have made no arrangement for relief from double income-tax.[1]

Chhota-Udepur. Indore. Kalsia. Mallerkotta. Mainpur.

[1] Vide p. 23. Income-Taxes in British Dominions.

APPENDIX XII

INCOME-TAX STATISTICS WITH REFERENCE TO ECONOMIC CONDITIONS

Table No. 1.	Figures of gross taxable income.
Table No. 2.	Details of income-tax payers with incomes above Rs. 2,000 arranged in income grades, for the years 1886-1926.
Table No. 3.	Quinquennial average of income-tax payers in income grades for the years 1886-1926.
Table No. 4.	Collection of income-tax classified by sources along with the proportion of the tax contributed by the different sources, 1886-1926.
Table No. 5.	Table showing the percentages of the total income-tax realized from the different provinces.
Table No. 6.	Number of assessees under each income grade in the different provinces for the year 1926-27.
Table No. 7.	The percentage of the different provinces in the assessees under each income grade for the year 1926-27.
Table No. 8.	Classification of income-tax by sources realized from the different provinces for the year 1926-27.

TABLE No. 1.

FIGURES OF GROSS TAXABLE INCOME, NUMBER OF ASSESSEES, AND INCOME PER ASSESSEE (FOR PERSONS WITH INCOMES OF AND ABOVE Rs. 2000.) (1886-1926).

Years	Number of Assessees	Gross Taxable Income	Income per Assessee
1886-87	44,941	33,28,38,336	7406
1887-88	52,567	33,32,39,527	6338
1888-89	54,885	34,69,65,136	6647
1889-90	56,059	38,25,77,680	6826
1890-91	56,808	38,52,13,862	6781
1891-92	58,573	39,45,84,368	6734
1892-93	59,808	40,45,95,225	6765
1893-94	60,998	40,01,73,164	6585
1894-95	62,891	44,07,86,379	7008
1895-96	65,291	44,67,10,348	6841
1896-97	66,354	45,99,21,000	6931
1897-98	68,995	46,19,94,624	6696
1898-99	69,075	46,79,41,964	6773
1899-00	71,070	47,59,70,496	6693
1900-01	70,932	48,77,82,835	6876
1901-02	72,843	50,71,96,683	6962
1902-03	75,822	51,90,57,551	6846
1903-04	75,933	53,08,33,382	7006
1904-05	80,933	56,12,19,353	6934
1905-06	83,812	58,63,40,888	6996
1906-07	87,375	64,19,43,398	7346
1907-08	90,777	68,56,79,201	7551
1908-09	93,035	70,34,48,077	7560
1909-10	96,048	70,21,66,541	7310
1910-11	95,647	69,25,71,110	7240
1911-12	100,337	77,39,95,187	7714
1912-13	106,323	76,81,09,069	7224
1913-14	112,284	87,45,83,156	7788
1914-15	118,819	91,73,23,161	7745
1915-16	120,324	93,93,23,404	7806
1916-17	129,941	88,03,07,904	6775
1917-18	143,910	108,87,01,641	7565
1918-19	175,185	174,67,60,542	9981
1919-20*	185,791	174,54,42,290	9389
1922-23	273,311	235,77,97,228	8626
1923-24	286,138	236,86,97,063	8269
1924-25	294,492	215,33,78,743	7312
1925-26	297,152	223,12,67,817	7509
1926-27	304,335	225,27,31,784	7402

As explained in the introduction to the statistical appendix, this table has been calculated from figure of tax realized by income grades given in the different issues of statistical abstract of British India (Financial Statistics); for the years 1922-26, they are taken from the All India Income-Tax Report and returns 1925 and 1926.

The figures of 1919-20 relate to preliminary assessment. No figures are available for the years 1920 and 1921.

TABLE No. 2.

NUMBER OF INCOME-TAX PAYERS WITH INCOMES ABOVE Rs. 2000 A YEAR (1886-1926).

Details in Income Grades.

YEARS	From 2,000 to 4,999	From 5,000 to 9,999	From 10,000 to 19,999	From 20,000 to 29,999	From 30,000 to 39,999	From 40,000 to 49,999	Rs. 50,000 and More	Total No. of Assessees
1886-87	32,055	78.48	3,096	936	435	204	927	44,941
1887-88	35,942	10,276	4,313	1,047	388	191	407	52,567
1888-89	37,917	10,448	4,392	1,051	433	184	460	54,885
1889-90	38,838	10,554	4,405	1,151	416	195	500	56,059
1890-91	39,213	10,897	4,403	1,112	418	215	520	56,808
1891-92	40,669	11,098	4,485	1,117	461	222	521	58,573
1892-93	41,495	11,110	4,595	1,082	483	242	501	59,808
1893 94	42,121	11,744	4,798	1,170	477	227	461	60,998
1894-95	43,028	11,828	5,332	1,331	588	252	532	62,891
1895-96	44,636	12,413	5,439	1,382	604	264	553	65,891
1896-97	45,589	12,556	5,439	1,313	558	278	621	66,354
1897-98	47,282	13,298	5,569	1,417	543	275	611	68,995
1898-99	47,549	13,309	5,507	1,343	526	266	573	69,075
1899-00	49,197	13,683	5,501	1,350	511	257	573	71,070
1900-01	49,085	13,542	5,518	1,357	558	280	592	70,932
1901-02	50,113	14,076	5,829	1,400	561	267	597	72,843
1902-03	52,746	14,317	5,940	1,398	539	272	605	75,822
1903-04	52,228	14,616	6,259	1,441	557	286	636	75,776
1904-05	55,985	15,825	6,286	1,577	571	289	697	80,933
1905-06	57,661	16,241	6,639	1,613	600	300	689	83,812
1906-07	60,210	16,876	6,815	1,678	643	299	851	87,375
1907-08	62,556	17,388	7,141	1,790	666	331	905	90,777
1908-09	63,115	17,885	7,018	1,725	730	352	910	93,035
1909-10	66,276	18,816	7,380	1,738	687	327	829	96,048
1910-11	65,320	19,217	7,110	1,979	706	372	863	95,647
1911-12	68,230	20,411	7,879	1,816	731	367	870	1,00,337
1912-13	72,609	21,581	8,192	1,880	741	462	918	1,06,323
1913-14	76,163	22,922	8,618	1,969	828	411	1,163	1,12,284
1914-15	81,057	24,025	9,160	2,274	769	427	1,167	1,18,819
1915-16	82,396	24,308	8,980	2,273	821	432	1,168	1,20,324
1916-17	84,761	28,273	11,643	2,702	830	470	1,259	1,29,941
1917-18	93,576	31,460	12,437	3,251	1,013	594	1,649	1,43,910
1918-19	1,12,370	38,753	11,577	4,369	1,417	780	2,831	1,75,185
1919-20	1,22,850	38,195	11,726	4,325	1,437	717	2,599	1,85,191
1922-23*	1,76,165	56,892	25,272	6,266	2,121	1,010	2,065	2,70,856
1923-24	1,80,527	58,137	25,612	6,622	2,508	1,759	2,963	2,86,438
1924-25	1,84,017	63,678	28,585	6,702	2,419	1,209	2,498	2,94,492
1925-26	1,84,523	63,051	28,311	7,081	2,707	1,282	2,389	2,97,152
1926-27	1,88,933	64,629	28,655	7,610	2,755	1,281	2,405	3,04,335

*The figures for 1919-20 relate to Preliminary Assessment. No figures are available for the years 1920 and 1921. The Figure for 1922-23 excludes Companies and Firms for which Statistics are not available.

Sources.

Statistics of British India Part iv (b) -5th Issue pp. 160.
do. do. 9th do. 269.
do. do. 10th do. 269 and 270.
All India Income-Tax Report and Returns—(1925-26) pp. 35.
do. do. do. (1926-27) pp. 32.

TABLE No. 3.

QUINQUENNIAL AVERAGE OF INCOME-TAX PAYERS IN INCOME GRADES FOR THE YEARS 1886-1926.

Period	From Rs. 2,000 to Rs. 5,000	From Rs. 5,000 to Rs. 10,000	From Rs. 10,000 to Rs. 20,000	From Rs. 20,000 to Rs. 30,000	From Rs. 30,000 to Rs. 40,000	From Rs. 40,000 to Rs. 50,000	From Rs. 50,000 and Upwards	Total Number of Assessees
1886-87 to 1890-91	36,399	10,005	4,122	1,059	418	198	451	52,652
1891-92 to 1895-96	42,390	11,698	4,932	1,216	523	241	514	61,514
1896-97 to 1900-01	47,740	11,274	5,507	1,356	540	271	593	67,281
1901-02 to 1905-06	53,747	15,015	6,192	1,498	562	285	645	77,944
1906-07 to 1910-11	63,615	18,036	7,265	1,782	656	332	872	92,588
1911-12 to 1915-16	76,139	22,655	8,773	2,012	778	408	1,033	111,828
1916-17 to 1919-20*	82,712	27,336	10,677	2,929	951	518	1,625	126,751
1922-23 to 1926-27	182,907	61,257	26,893	6,862	2,509	1,326	2,164	284,218

*As observed in the Note to this Appendix, no figures for the years 1919-20 and 1920-21 are available.

TABLE No. 1.

COLLECTIONS OF INCOME-TAX CLASSIFIED BY SOURCES ALONG WITH THE PROPORTION OF THE TAX CONTRIBUTED BY EACH SOURCE, 1886-1903.

(Amount of Tax shown in Lakhs of Rupees)

Year	Total Tax	Income from Salaries: Amount	Income from Salaries: Percentage	Income from Interest on Securities: Amount	Income from Interest on Securities: Percentage	Income from House Property: Amount	Income from House Property: Percentage	Income from Business: Amount	Income from Business: Percentage	Income from Profession: Amount	Income from Profession: Percentage	Income from Other Sources: Amount	Income from Other Sources: Percentage
1886-87	136·9	41·3	30·1	7·3	5·2	4·3	3·1	78·1	55·8	5·9	4·2		
1887-88	139·7	41·2	29·4	8·5	6·0	4·7	3·4	79·1	56·4	6·3	4·5		
1888-89	149·3	45·5	30·2	9·2	6·1	5·5	3·6	82·8	55·2	6·1	4·1		
1889-90	155·4	45·9	29·7	9·3	5·7	6·1	3·8	87·1	56·1	6·7	4·5		
1890-91	157·8	46·4	29·1	9·9	6·1	6·1	3·7	88·4	55·2	6·8	4·3		
1891-92	160·9	47·5	29·6	9·3	5·8	6·5	3·9	90·3	56·4	7·1	4·4		
1892-93	165·6	48·1	28·2	9·4	5·5	7·1	4·1	93·4	55·1	7·4	4·4		
1893-94	171·1	51·1	30·1	9·1	5·4	6·9	4·1	96·1	56·4	7·6	4·4		
1894-95	178·6	53·5	29·7	10·6	5·9	7·2	4·0	99·5	55·3	7·8	4·3		
1895-96	181·7	55·0	30·5	9·1	5·0	7·6	4·2	102·0	56·3	7·9	4·4		
1896-97	185·6	54·7	28·7	9·2	4·9	7·7	4·1	105·8	55·6	8·1	4·2		
1897-98	187·5	55·7	29·2	9·5	5·0	8·0	4·2	106·1	55·8	8·2	4·3		
1898-99	190·5	56·3	29·1	9·6	5·0	8·1	4·2	108·2	57·4	8·3	4·5		
1899-00	193·3	56·9	29·4	9·9	5·2	8·3	4·3	109·2	59·1	8·6	4·6		
1902-03	208·2	60·2	28·9	9·6	4·6	8·4	4·0	118·4	56·9	8·7	4·2	3·0	1·4

†Year	Total Tax	INCOME FROM SALARIES		INCOME FROM INTEREST ON SECURITIES		INCOME FROM HOUSE PROPERTY		INCOME FROM BUSINESS		INCOME FROM PROFESSION		INCOME FROM OTHER SOURCES	
		Amount	Percent-age	Amount	Percent-age	Amount	Percent-age	Amount	Percent-age	Amount	Percent-age	Amount	Percent-age
1903-04	178·1	52·8	29·6	9·7	5·5	8·1	4·5	97·7	54·9	7·5	4·2	2·3	1·3
1904-05	188·0	54·6	29·0	9·9	5·3	8·5	4·5	104·9	55·8	8·0	4·3	2·1	1·1
1905-06	195·5	57·0	29·1	10·1	5·2	8·6	4·4	109·3	55·9	8·2	4·2	2·3	1·2
1906-07	211·7	59·8	28·2	10·5	5·0	9·2	4·4	120·4	56·9	8·5	4·1	2·8	1·4
1907-08	224·4	63·2	28·3	11·0	4·9	10·4	4·7	127·3	57·0	8·8	4·0	2·5	1·1
1908-09	230·2	65·6	28·9	11·6	5·0	11·5	5·0	128·2	56·0	9·2	4·0	2·6	1·1
1910-11	229·6	64·1	28·2	11·9	5·2	12·3	5·4	126·1	55·4	10·4	4·6	2·8	1·2
1911-12	240·3	68·4	28·7	12·7	5·3	12·1	5·1	131·3	55·2	10·4	4·4	3·1	1·3
1913-14	284·0	74·3	26·4	12·8	4·5	15·1	5·4	163·8	58·3	11·9	4·2	4·0	1·4
1916-17	554·8	111·0	20·2	33·6	6·1	25·1	4·6	351·3	63·9	18·2	3·3	10·8	1·9
1919-20	909·9	157·2	16·2	37·2	4·1	20·1	2·2	586·4	64·5	15·0	1·7	91·1	13·5
1922-23	1216·0	239·2	19·7	61·2	5·1	46·6	3·8	798·6	65·9	24·4	2·0	45·9	3·6
1923-24	1316·4	254·9	19·3	65·1	5·0	59·3	4·5	856·5	65·1	28·8	2·2	51·8	3·9
1924-25	1233·8	260·7	21·1	55·8	4·5	61·5	5·0	775·6	62·9	31·5	2·5	48·7	4·0
1925-26	1303·0	284·0	21·8	65·1	5·0	64·7	4·9	814·2	62·5	30·9	2·4	44·0	3·4
1926-27	1320·6	290·2	22·0	73·4	5·6	68·6	5·2	814·3	61·6	30·7	2·3	43·3	3·3

† Figures of the years 1900-01, 1901-02, 1909-10, 1912-13, 1914-15, 1915-16, 1917-18, 1918-19, 1920-21 and 1921-22 are not available in any published Government Report.

TABLE No. 5.

TABLE SHOWING THE PERCENTAGES OF THE TOTAL INCOME TAX REALIZED FROM THE DIFFERENT PROVINCES

1887-88	Bombay	Bengal	Madras	United Provinces	Burma	Punjab	Assam	Central Provinces	Bihar and Orissa*	Other Provinces and Departments of Government **
1887-88	[illegible]	[illegible]	10·7	[illegible]		6·9	1·5	2·2		14·4
1888-89	[illegible]	[illegible]	9·8	14·3	3·6	6·8	1·4	2·2		14·5
1889-90	[illegible]	[illegible]	10·1	14·1	3·6	7·1	1·4	2·4		13·9
1890-91	[illegible]	[illegible]	10·7	14·0	3·7	7·4	1·3	2·3		14·0
1891-92	[illegible]	[illegible]	10·6	[illegible]	4·1	7·4	1·4	2·2		13·6
1892-93	[illegible]	[illegible]	10·9	13·6	4·1	7·3	1·4	2·4		13·2
1893-94	[illegible]	[illegible]	11·0	13·7	4·4	7·3	1·5	2·3		13·1
1894-95	[illegible]	[illegible]	[illegible]	13·3	4·3	7·2	1·5	2·2		13·2
1895-96	[illegible]	[illegible]	12·1	[illegible]	4·1	7·0	1·6	2·1		12·8
1896-97	[illegible]	[illegible]	12·9	12·9	4·2	7·2	1·6	2·2		12·5
1897-98	[illegible]	[illegible]	13·0	[illegible]	5·0	7·5	1·6	1·9		12·4
1898-99	[illegible]	[illegible]	13·1	[illegible]	5·3	7·2	1·7	2·0		11·7
1899-1900	19·8	[illegible]	[illegible]	12·6	5·4	7·2	1·7	2·0		11·4
1900-01	19·3	[illegible]	[illegible]	[illegible]	5·7	7·5	1·5	1·8		11·6
1901-02	18·6	[illegible]	13·9	12·3	5·9	6·9	1·5	1·7		11·8
1902-03	18·6	[illegible]	13·9	[illegible]	5·8	6·9	1·5	1·7		11·7
1903-04	[illegible]	[illegible]	13·0	11·1	6·6	6·5	1·4	1·6		12·1
1904-05	[illegible]	[illegible]	13·2	10·8	7·2	6·4	1·3	2·9		11·9
1905-06	19·1	[illegible]	13·1	10·5	7·8	6·3	4·8	2·9		11·8
1906-07	[illegible]	[illegible]	[illegible]	9·9	7·3	6·3	4·8	2·3		11·3
1907-08	[illegible]	[illegible]	13·1	9·7	7·9	6·1	4·9	2·6		11·2
1908-09	[illegible]	[illegible]	[illegible]	9·7	7·7	6·1	5·1	2·5		11·1
1909-10	[illegible]	[illegible]	13·4	9·5	7·9	6·2	5·2	2·3		11·5
1910-11	[illegible]	[illegible]	13·3	10·5	8·2	6·5	5·4	2·6		8·3
1911-12	[illegible]	[illegible]	13·1	10·0	8·1	6·7	1·6	2·9	4·9	8·2
1912-13	[illegible]	[illegible]	13·5	9·9	7·4	6·9	1·6	2·9	5·2	7·8
1913-14	[illegible]	[illegible]	[illegible]	9·3	8·0	6·6	1·5	2·9	4·8	7·2
1914-15	[illegible]	[illegible]	13·3	8·9	8·5	6·6	1·5	2·9	4·7	7·3
1915-16	[illegible]	[illegible]	13·0	9·1	8·1	6·4	1·5	3·5	4·6	7·1
1916-17	[illegible]	30·1	10·1	7·6	7·0	5·4	1·2	2·3	3·6	7·5
1917-18	[illegible]	[illegible]	10·3	6·5	6·6	4·9	1·1	2·1	3·1	7·7
1918-19	[illegible]	30·3	8·7	[illegible]	6·8	3·4	0·7	1·6	2·4	6·4
1919-20	31·1	[illegible]	9·3	[illegible]	7·2	3·6	0·6	2·1	2·5	5·9
1920-21	30·0	[illegible]	7·1	4·3	8·4	2·0	0·5	1·7	1·8	4·9
1921-22	[illegible]	[illegible]	7·7	5·1	6·9	2·6	0·4	2·6	1·9	5·0
1922-23	[illegible]	[illegible]	7·3	5·4	8·5	4·2	0·5	3·3	3·2	6·1
1923-24	[illegible]	[illegible]	[illegible]	4·8	8·1	4·1	0·8	3·1	2·6	5·8
1924-25	[illegible]	[illegible]	8·1	4·8	10·9	3·7	1·5	3·1	2·5	6·1
1925-26	[illegible]	[illegible]	8·7	4·9	11·6	4·0	1·2	2·3	2·3	6·6
1926-27	[illegible]	31·9	8·3	4·7	12·9	4·2	2·2	2·5	3·6	6·8

* The Province of Bihar and Orissa was created only in 1911.

** "Other provinces and departments of Government" include North-West Frontier Province, Delhi, Baluchistan, Ajmer Merwara, Coorg, Mount Abu, in addition to the tax realized from the civil and military station, Bangalore and India (Central).

TABLE No. 6.

NUMBER OF ASSESSEES UNDER EACH INCOME GRADE IN THE DIFFERENT PROVINCES FOR THE YEAR, 1926—27.

	From Rs. 2,000 to Rs. 4,999	From Rs. 5,000 to Rs. 9,999	From Rs. 10,000 to Rs. 19,999	From Rs. 20,000 to Rs. 29,999	From Rs. 30,000 to Rs. 39,999	From Rs. 40,000 to Rs. 49,999	Rs. 50,000 and over.	TOTAL
Madras	22,619	9,445	4,039	1,179	468	176	287	38,216
Bombay	44,496	13,463	6,106	1,722	657	363	708	67,515
Bengal	22,269	9,812	4,387	1.167	457	223	532	38,847
United Provinces ...	15,990	4,688	1,536	364	156	60	98	22,892
Punjab	16,504	5.974	2,310	542	171	68	148	25,717
Burma	16.258	4.974	2,718	815	388	224	397	25,774
Bihar and Orissa ...	8,585	3.275	1,347	349	120	69	89	13,834
Central Provinces and Berar	9.007	2.846	1,061	250	71	30	56	13,321
Assam	3.212	1.386	649	190	69	14	20	5.510

TABLE No. 7.

THE PERCENTAGE OF THE DIFFERENT PROVINCES IN THE NUMBER OF ASSESSEES UNDER EACH INCOME GRADE FOR THE YEAR 1926-27.

Income grade	Madras	Bombay	Bengal	United Provinces	Punjab	Burma	Bihar and Orissa	Central Provinces and Berar	Assam
From Rs. [illegible] to Rs. 4,999	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
From Rs. 5,000 to Rs. 9,999	[illegible]	24·20	17·70	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
From Rs. 10,000 to Rs. 19,999	16·72	25·28	18·16	6·35	[illegible]	[illegible]	[illegible]	1·70	[illegible]
From Rs. 20,000 to Rs. 29,999	17·80	26·13	17·71	5·52	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
From Rs. 30,000 to Rs. 39,999	18·30	25·69	17·87	6·10	6·68	15·17	1·69	2·77	2·69
From Rs. 40,000 to Rs. 49,999	14·34	29·58	18·17	4·88	5·51	18·25	5·62	2·11	1·11
From Rs. 50,000 and over	12·30	30·32	22·77	4·12	6·33	17·002	3·81	2·39	0·85

TABLE No. 8.

CLASSIFICATION OF INCOME-TAX BY SOURCES REALIZED FROM THE DIFFERENT PROVINCES FOR THE YEAR, 1926-27.

AMOUNT IN THOUSANDS OF RUPEES AND PERCENTAGE TO TOTAL TAX REALIZED UNDER EACH SOURCE

Name of Province	Business		Salaries		Securities		Property		Professional earnings	
BOMBAY	15,885	19·5	5,118	17·6	3,438	46·8	2,653	38·68	918	29·9
BENGAL	25,239	31·0	5,947	21·8	1,002	13·6	1,615	23·6	617	20·1
MADRAS	8,761	10·8	2,208	7·6	248	3·4	480	7·0	364	11·8
U. P.	3,953	4·9	1,613	5·6	176	2·4	368	5·4	297	9·7
PUNJAB	4,238	5·2	1,265	4·4	225	3·1	529	7·7	267	8·7
BURMA	14,491	17·8	2,659	9·1	169	2·3	655	9·5	241	7·9
BIHAR AND ORISSA	2,433	3·0	1,238	4·3	34	·5	155	2·3	201	6·5
CENTRAL PROVINCES	2,805	3·4	630	2·2	24	·3	146	2·1	103	3·3
ASSAM	2,015	2·5	1,057	3·6	5	·07	20	·3	23	·7

APPENDIX XIII

RECENT CHANGES IN THE INDIAN INCOME-TAX

Since the original preparation of this book, a number of changes have been effected in the Indian income-tax system. The more important of these are three in number and relate to graduation, Company taxation and administrative procedure.

The Finance Bill of 1930 revised income-tax rates uniformly by one pie in the rupee. The Finance Bill of 1931 effected more drastic addition to the rates, substantially altering the curve of graduation. The new rates of income-tax are as under:—

Annual income				Pies per Rupee.
From Rs. 2000 to	Rs. 4999	...	...	6
,, ,, 5000 ,,	,, 9999	...	...	9
,, ,, 10000 ,,	,, 14999	...	...	12
,, ,, 15000 ,,	,, 19999	...	...	16
,, ,, 20000 ,,	,, 29999	...	...	19
,, ,, 30000 ,,	,, 39999	...	...	23
,, ,, 40000 ,,	,, 99999	...	...	25
On incomes of more than Rs.	100000	...	...	26

The exemption limit for super-tax has now been reduced from Rs. 50,000 to Rs. 30,000 for individuals and unregistered firms, the exemption for Hindu Undivided Families remaining undisturbed at Rs. 75,000. The new rates of super-tax are as under:—

For Hindu Undivided Families:—

	Rate per Rupee.
On the first 45 thousand rupees in excess of 30,000	Nil.
On the next 25,000	1 anna 3 pies

For individuals and unregistered firms:—

On the first 20 thousand rupees in excess of 30,000	9 pies
On the next 50,000	1 anna 3 pies

**For individuals, Hindu undivided families
ind unregistered firms:—**

On every rupee of the next	50,000	...	1 anna	9 pies
,, ,, ,,	50,000	...	2 annas	3 pies
,, ,, ,,	50,000	...	2 annas	9 pies
,, ,, ,,	50,000	...	3 annas	3 pies
,, ,, ,,	50,000	...	3 annas	9 pies
,, ,, ,,	50,000	...	4 annas	3 pies
,, ,, ,,	50,000	...	4 annas	9 pies
,, ,, ,,	50,000	...	5 annas	3 pies
,, ,, ,,	50,000	...	5 annas	9 pies
On every rupee of the remainder of such excess		...	6 annas	3 pies

The maximum rate of super-tax has thus been increased by : pies in the rupee. The super-tax on companies remains ınchanged at one anna in the rupee.

Act XXI of 1930 effects an important change by the addition ıf section 21-A which gives power to the Income-Tax Officer to ıssess individual members of such firms, associations and companies ıs are suspected of having been formed or being used for the ›urpose of evading or reducing the liability to tax of the members hereof. Whenever the firm or association is a one-man concern, he Income-Tax Officer has power to direct that income-tax be ıot levied on the firm or association, and thereupon the individual nember will become liable to both income and super-tax on his ncome from such a concern at his personal rates. In the case of company, similar measures are to be taken when the company s under the control of not more than five persons and has ccumulated reserves beyond its reasonable needs. The provisions ıre not to apply to subsidiary companies and to companies in vhich the public are substantially interested, the evidence of uch interest being the holding of 25 per cent of the shares by he public, and dealings in the same in any stock exchange in British India. These measures are not accompanied by a repeal ıf the company super-tax on such companies.

It is also provided that appeals against the order of any Income-

Tax Officer under the new Section 21-A shall be to a Board of Referees which shall not be revised by the Commissioner of Income-Tax. The Board shall consist of not less than three and not more than five persons, of whom not less than one-half shall be non-officials having business experience, and one shall be a judicial officer of not less than ten years' standing.

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